

IN THE

Supreme Court of the United States

October Term, 1977

No. **77-1638**

JAMES E. CRANE; JAMES E. CRANE,
M.D., P.C.; and JAMES E. CRANE and
MARY ELLEN CRANE, TRUSTEES OF
JAMES E. CRANE, M.D., P.C. PENSION
TRUST (on behalf of themselves and inves-
tors similarly situated),

Petitioners,

v.

LESLIE A. BARTH; BERGMAN AND BARTH,
P.C.; PIERSON, DUEL & HOLLAND; and
RITCH, GREENBERG & HASSAN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF
APPEALS FOR THE SECOND CIRCUIT

TOBIAS WEISS
Attorney for Petitioners
26 Sixth Street
Stamford, Connecticut 06905
(203) 348-6196

(7220)

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No.

JAMES E. CRANE; JAMES E. CRANE, M.D.,
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PETITION FOR A WRIT OF CERTIORARI
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APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of
certiorari issue to review the judgment

of the United States Court of Appeals for the Second Circuit, entered in the above-entitled case on January 5, 1978.

OPINIONS BELOW

The Court of Appeals did not render an opinion, affirming on the opinions of the District Court, which were not reported and which are annexed as Appendix D, E and F.

JURISDICTION

The judgment of the Court of Appeals was entered on January 5, 1978. A petition for rehearing was filed on January 18, 1978, and was denied on February 17, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

(1) Whether investors, in a fraudulent securities issue to which the federal securities acts apply, are to be denied access to the federal courts by imposing pleading requirements calling for inclusion of detailed evidence in the complaint.

(2) Whether lawyers and accountants (professionals), whose services are essential for the issuance and sale of such fraudulent securities, and whose names or opinions or exhibits are also presented to the public for that purpose, have a duty under the federal securities acts to disclose pertinent facts which they know and which would alert investors to the fraud.

RULES AND STATUTES INVOLVED

The pertinent Federal Rules of Civil Procedure are FRCP 8(a) and (e), 9(b), and Form 13 appended to the Federal Rules of Civil Procedure.

The pertinent statutory provisions are Sections 12(2) and 17(a)(2) of the Securities Act of 1933, and Section 10(b) of the Securities Exchange Act of 1934. Relevant with respect to Section 10(b) are S. E. C. Regulation 10b-5.

STATEMENT

The complaint is the only pleading in the case. No answers were filed by the defendants. After a number of extensions of their time to respond, defendants filed motions to dismiss the complaint,

to which plaintiffs filed opposing papers. Those motions were granted, and the dismissal was affirmed by the court below.

In view of the foregoing, the allegations of the complaint are taken to be admitted and assumed to be true. Cruz v. Beto, 405 U.S. 319, 322 (1972); Jenkins v. McKeithan, 395 U.S. 411, 421-422 (1969).

The complaint has the following basic structure: The first count sets forth the means by which the promoter and issuer of the securities worked their manipulation and deception. The second count deals with the Hassan Firm (defendants). The third count deals with the Duel Firm (defendants). The fourth count deals with the Barth Firm (defendants). Subsequent counts tie into that structure.

Stonehenge Industries, Inc.

("Stonehenge") was a Delaware corporation engaged in the business of syndicating real estate investments in the form of limited partnerships, in which interests were offered and sold to the public (par. 11(a)). None of those syndications was registered under the federal securities laws although such registration was required (par. 19, 20, 21). Three such syndications were Carlene Tower Associates ("Carlene"), Reading-Easton Associates ("Reading-Easton") and Clementon Associates ("Clementon"), which were supposed to operate real estate in Pennsylvania and New York.

The plaintiffs are Dr. James E. Crane, a physician at Stamford, Connecticut, and

his wife Mary Ellen Crane. They invested \$13,000 in Carlene, \$26,000 in Reading-Easton, and \$7,500 in a debenture of Clementon (par. 9).

These Stonehenge syndications were all arranged by Howard N. Garfinkle ("Garfinkle") in collusion with Anthony A. Constantine and David A. Ward (par. 22), who respectively were the President and Vice-President and Secretary of Stonehenge (par. 11(a)). All the properties of the syndications were acquired from Garfinkle (par. 22, 25), who bought them with little or no cash (par. 25) and sold them at substantial mark-ups to the syndications (par. 26) on terms dictated by Garfinkle, and on arrangements (sale and leaseback; management contracts)

which left the properties in Garfinkle's control even after they were bought by the syndications (par. 29). The principal manipulative device used by Garfinkle and his henchmen was the "wrap-around" mortgage running to Garfinkle (par. 27, 28), which was placed on all properties, and the mechanics of which are explained in Appendix I. The syndications were organized and operated (par. 33) for the benefit of Garfinkle, Constantine and Ward, and not for the benefit of the investors (par. 24), and their investments were doomed from the outset (par. 12, 31). Eventually all the properties of these syndications were lost through foreclosure (par. 31). The fraud and deception were so flagrant that the S. E. C.

obtained an injunction against the sale of these securities (par. 13).

The professionals who worked with Stonehenge, Constantine and Ward knew the facts set forth above or intentionally shut their eyes to those facts, and cooperated in suppressing disclosure or even engaging in affirmative misrepresentation (pars. 20 through 36, 45, 46, 51, 52, 54, 57, 77, 78, 99, 114, 115). Those professionals, the parts they played in the issuance, offer and sale of these securities, the basis for their duty of disclosure, and their breach of that duty, were as follows:

(1) The Hassan Firm. Ritch, Hassan & Greenberg were certified public accountants for both Stonehenge and

the syndications (par. 44, 47). They prepared financial statements to be used to solicit investors in these syndications (par. 50 et seq.). Those statements are annexed to the complaint (Appendix A) as Exhibits A, B, and C. Those statements were not only misleading and deceptive in material ways, but violated the professional standards of the American Institute of Certified Public Accountants (AICPA), in failing to show the following facts at least in notes or comments to the statements: (a) The data was presented by the Hassan Firm as "actual" (par. 51, 52), whereas the Hassan Firm did not know whether it was actual or historic information, and in fact the information was not accurate (par. 51, 52). (b) All the

information thus presented was obtained by the Hassan Firm from Garfinkle, without any independent investigation by the Hassan Firm, and in fact those data were artificially created by Garfinkle (par. 51, 52, 53). (c) There was omitted any information about the "wrap-around" nature of the mortgage, or the absence of any protective arrangement such as provision for escrow of monies paid to Garfinkle, all of which was completely ignored by the Hassan Firm (par. 49, 50). (d) Similarly, there was a complete omission of any reference or information of the lease-backs to Garfinkle or the management contracts with Garfinkle (par. 59, 50). (e) The S. E. C. required registration of the issue and sale of these securities, but they were not being registered (par. 57).

With respect to the foregoing, there were specific AICPA standards which the Hassan firm violated, as set forth in pars. 60, 61, 62, 63, 64, 65.

(2) The Duel Firm. Pierson, Duel & Holland was a law firm specializing in real estate (par. 69). The Duel firm acted as counsel to Stonehenge and the syndications (par. 70). The Duel firm represented Stonehenge in acquiring the syndication properties from Garfinkle (par. 72). Arthur Duel, a partner of the firm, served as Vice-President and Assistant Secretary of Stonehenge (par. 73). In addition, the Duel firm undertook, with respect to Clementon, to act "as agent for the debenture holders" (par. 82, 83). All those facts were presented to the public to induce

purchase of these securities (par. 83). The Duel firm, despite its position and knowledge, intentionally said nothing about the following facts: (a) The properties were all acquired from Garfinkle, on terms always favorable to Garfinkle, with an absence of arms-length dealing. (b) The nature of the "wrap-around" mortgage to Garfinkle and the absence of protective provisions against Garfinkle, such as use of an escrow. (c) The artificial increase in sales price to the syndications for the properties. (d) Other specific facts relating to the properties bought from Garfinkle (par. 78).

As agent for purchasers of Clementon debentures, the Duel firm owed them the duty to disclose such pertinent information (par. 84, 85), and yet it made no

disclosure at all to them.

(3) The Barth Firm. Bergman and Barth, P. C., was a law firm specializing in securities and tax matters (par. 91). The Barth Firm advised Stonehenge on securities questions (par. 92) and also issued a tax opinion which was distributed on Barth firm stationery to the public to induce the purchase of the securities in Clementon (par. 95) and which is attached to the complaint (Ex. D to Appendix A). In view of other legal services it rendered for Stonehenge, the Barth firm was not independent but failed to disclose that fact in its opinion (par. 94(cc)). Moreover, the S. E. C. required a tax opinion on a real estate syndication to cover certain matters, and the Barth opinion failed to do so (par. 94(aa), (ff),

referring to the specific S. E. C. directive). In addition, the Barth firm had knowledge of the fraudulent facts, but intentionally failed to make any disclosure, and its tax opinion was misleading as a result of deliberately ignoring the impact of those facts for tax purposes (par. 94(dd) through (rr), 94(ww)):

(a) There was a failure to state the source of the facts on which the opinion relied, as required by American Bar Association, Committee on Ethics, Formal Opinion 333 (Feb. 3, 1974), or even to state the facts or the documents on which it relied. (b) On the matter of recognition as a partnership for income tax purposes, there was a failure to warn of the risk that the Internal Revenue Service

would refuse to issue a ruling granting such recognition and the risk that there would be litigation with I. R. S. (c) In view of the collusive sales prices for the syndication properties, there was a failure to warn of the risk that the important tax feature of depreciation would not be accepted on the basis of those sales prices. (d) Failure to warn that the investors could realize taxable gain when their investments became worthless (the probable prospect from the outset).

The Barth opinion, the Hassan exhibits, and the publicized Duel participation, in addition to their detailed contributions, had the overall effect of creating an umbrella of legitimacy, in the eyes of small and medium investors, for a fraudulent securities issue.

SPECIFICATION OF ERRORS TO BE URGED

(1) In holding that the complaint was insufficient as a pleading under the Federal Rules of Civil Procedure and thus excluding plaintiffs from the Federal courts.

(2) In holding that none of the defendants had a duty of disclosure to the plaintiffs under the Federal securities acts.

(3) In affirming the orders of the District Court.

REASONS FOR GRANTING THE WRIT

The writ should be granted because there is a conflict between the decision of the court below in the instant case and the decisions of courts of appeal and district courts in other circuits; and because the areas involved are important

in the administration of the Federal securities acts.

The decision of the court below is in conflict, in principle and in result, with Federal courts in other circuits both with respect to the standard to be applied under FRCP 9(b) and with respect to the holding on particular complaint allegations.

See Tamara v. Galt, 511 F. 2d 504 (7th Cir. 1975); Dudley v. Southeastern Factor & Finance Corp., 446 F. 2d 383 (5th Cir. 1971); Fox v. Prudent Resources Trust, 382 F. Supp. 81, 95-96 (E.D. Pa. 1974); Burkhart v. Allison Realty Trust, 363 F. Supp. 1286, 1289 (N.D. Ill. 1973); Collins v. Rukin, 342 F. Supp. 1282, 1292 (D. Mass. 1272); Cash v. Frederick & Co., Inc., 57 F.R.D. 73, 77 (E.D. Wis. 1972).

The decision of the court below is also inconsistent with the fraud allegation (par. 4) of Supreme Court Form 13 appended to the Federal Rules of Civil Procedure.

Thus, in Tamara v. Galt, supra, a complaint, based on Sec. 10(b) and 10(b)-5, was held to satisfy FRCP 9(b) where it only alleged that plaintiff bought stock in mining companies and that defendant said that the mining companies had valid mine leases, were carrying on mining operations, and would use the invested funds to develop the mine property. These allegations were no more particularized than in the instant case, and yet were sufficient.

In Fox v. Prudent Resources Trust, supra, FRCP 9(b) was held to be satisfied

by an allegation that there was self-dealing by insiders to the enrichment of the general partner. No further particulars were required in the complaint. Such self-dealing by Garfinkle and the Stonehenge officers, for their own benefit and enrichment, is alleged in the instant case (e.g. par. 22, 24, 25, 30, 55).

Cash v. Frederick & Co., Inc., supra, held an allegation to be sufficient under FRCP 9(b) which asserted that the defendant failed to provide information based on a diligent or independent investigation, just as in the present case it was alleged that the Hassan firm and the defendants merely accepted information fed to them by Garfinkle (par. 51, 52, 53).

It is also inconsistent with the above-cited cases for the court below to

hold that FRCP 9(b) was not satisfied by allegations of a failure to disclose that

(a) The properties of all the syndications were bought from Garfinkle; (b) Garfinkle was given lease-backs or management contracts on all the properties after he sold them; (c) Garfinkle was given "wrap-around" mortgages on all the properties, with no safeguard (such as escrow) against his misappropriation of funds paid to him. Similarly, it was inconsistent with those cases for the court below to hold that the specifically pleaded claims described above, against the Hassan exhibits or the Barth tax letter, do not satisfy FRCP 9(b).

The source of the conflict, between the courts deciding the above-cited cases and the court below, is in the standard applied under FRCP 9(b). The other courts

read FRCP 9(b) in the context and rationale of FRCP 8(a)(2), (e)(1), and (f), see Tamara v. Galt, supra, at 508, as do the major commentators, see Wright & Miller, Federal Pleading & Practice, §1298, at 406-410. In contrast, the court below requires the complaint to plead detailed evidentiary matter, and would convert the complaint under FRCP 9(b) into a bill of particulars.

The effect of the decision below is to exclude small and medium investors from access to the federal courts. Especially in a case of concealment or omission of material information, the amount of detailed evidence the small or medium investor can have in advance of starting suit is very limited, and the heavy and excessive pleading burden imposed by the

court below can only bar him from the federal courts. The effect of such a procedural requirement is to deny relief completely, since it rarely will be available under the limited and varied state securities acts.

With respect to the duty owed by these professionals to the investors, the decision below is likewise inconsistent with other authority. Thus, with respect to professionals like the Duel Firm and the Barth Firm, it was held that a duty existed on a law firm whose name was used in connection with the sale of securities. Black & Co. v. Nova-Tech, Inc., 333 F. Supp. 468, 472 (D. Ore. 1971). See also Lewis v. Walston & Co., Inc., 487 F. 2d 617 (5th Cir. 1973). The duty of an accountant was reflected in a holding that

he was not relieved by labelling his statement as "unaudited," U. S. v. Natelli, 527 F. 2d 311, 320, or as "pro forma," U. S. v. Benjamin, 328 F. 2d 854, 860-861. In the latter case the court said that those two Latin words did not shelter an accountant whose "reports were little more than regurgitation of material handed him by management." Nor would such an accountant be sheltered under the professional standards of the AICPA alleged in the complaint.

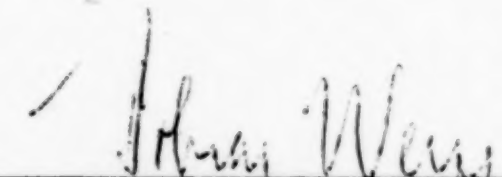
These questions are of importance in the administration of the Federal securities acts, particularly with respect to small and medium investors. They are peculiarly affected by such onerous pleading rules as a condition for access to the courts, normally not having or being able to obtain extensive information in

advance of suit; and they uniquely are attracted to investments by a display of professionals and their product, such as appeared in this case.

The decision below is believed to be erroneous in its holding that the complaint herein did not satisfy the pleading requirements of the Federal Rules, and in its holding that a cause of action under the Federal securities acts was not alleged.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.



Tobias Weiss
Counsel for Petitioners

APPENDIX A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- - - - - x

JAMES E. CRANE; JAMES E. :
CRANE, M.D., P.C.; and :
JAMES E. CRANE and MARY :
ELLEN CRANE, TRUSTEES OF :
JAMES E. CRANE, M.D., P.C. :
PENSION TRUST (on behalf :
of themselves and all in- :
vestors similarly situated), :

Plaintiffs, 75 Civ. 5995 :
: Judge Metzner

v.

STONEHENGE INDUSTRIES, : Amended Com-
INC.; ANTHONY A. CONSTAN- : plaint --
TINE; DAVID A. WARD; : Class Action
DUNCAN Y. HENDERSON; :
HOWARD N. GARFINKLE; :
ARTHUR GRAYSON; GRAYSON :
SECURITIES, INC.; DONALD :
L. LAWRENCE; LESLIE A. :
BARTH; BERGMAN and BARTH, :
P.C.; PIERSON, DUEL & :
HOLLAND; and RITCH, :
GREENBERG & HASSAN, :

Defendants. :

- - - - - x

Plaintiffs, by Tobias Weiss, their

attorney, for their complaint, respectfully allege, upon information and belief except as to pars. 1, 2, 3, 4, 5, 6, 7, 8, 9 and 10:

Jurisdiction and Venue

1. The jurisdiction of the court is based upon section 22 of the Securities Act of 1933, as amended, 15 U.S.C. §77a; and Section 27 of the Securities Exchange Act of 1934, as amended, 15 U.S.C. §78a; and upon principles of pendent jurisdiction.

2. Plaintiffs bring this action under and pursuant to:

(a) Sections 5, 12(2), and 17(a) of said Securities Act of 1933; and sections 10(b), 15(c) and 20(a) of said Securities Exchange Act of 1934; and the related rules and regulations of the Securities and Exchange Commission.

(b) Principles of fraud, and of misrepresentation by commission and

omission; and principles of negligent misrepresentation by commission and omission.

(c) Breach of agency and fiduciary duty.

The Securities act of 1933 is herein also referred to as the "Act"; and the Securities Exchange Act of 1934 is herein also referred to as the "Exchange Act". The Securities and Exchange Commission is herein also referred to as the "S.E.C.".

3. This action is based on acts and transactions constituting violations of the United States securities laws, occurring within or connected with violations occurring within, the jurisdiction of the United States District Court for the Southern District of New York, and involve or relate to the offer, sale and purchase of certain limited partnership interests and debentures by or for or through Stonehenge Industries, Inc., a

Delaware corporation authorized to do business in the State of New York and having an office in the City and State of New York. Said Stonehenge Industries, Inc. has filed proceedings under the federal bankruptcy statutes in the United States District Court for the Southern District of New York, and it alleged therein that its principal place of business was in the City and State of New York. An action for an injunction and for other relief against said Stonehenge Industries, Inc. has been brought by the S.E.C. in the United States District Court for the Southern District of New York, alleging that acts and violations of the United States securities laws (including those involved herein) occurred within the jurisdiction of the United States District Court for the Southern District of New York; and that action has resulted in a permanent injunction being issued against said Stonehenge Industries,

Inc. by the United States District Court for the Southern District of New York.

Class Action Allegations

4. This action is properly maintainable as a class action under FRCP 23(b)(1)(A) and (B) (adjudications in different districts and by individual plaintiffs creates the risk of establishing incompatible rulings and standards, and would interfere with ability of other plaintiffs to protect their interests); FRCP 23(b)(2) (this court has approved of injunctive relief in the present situation); FRCP 23(b)(3) (the questions of law and fact common to all members of the class overwhelmingly predominate over any questions of individual interest only, and this class action by far is superior to a host of multiple, duplicating actions here).

5. The factual allegations of the complaint apply to all the plaintiffs, with

the very few exceptions where they specifically are asserted as applicable only to Crane.

6. Further with respect to Civil Rule 11A(b)(2):

(i) The class consists of about 75 persons.

(ii) The class is comprised of all persons who purchased limited partnership interests or debentures in the three real estate syndications known as Reading-Easton Associates, Carlene Tower Associates and Clementon Associates.

(iii) The principal plaintiff is a physician, licensed and practicing in Connecticut, and is very interested in and financially capable of prosecuting this action.

(iv) The common questions of fact relate inter alia: to the misrepresentations by omission and commission in

the offering of literature relating to all these investments; and to the circumstances in which all these investments were offered and sold to all members of the class. The facts concerning the syndications are the same for all members of the class, as are the facts as to the misleading omissions and misrepresentations. The parts played by these defendants with respect to matters in the complaint are the same as to all the investors. Essentially all the allegations of the complaint are common to all members of the class, such as questions concerning violation of the securities laws, breach of trust, fraud, etc.

(v) With respect to FRCP 23(b), it has been indicated herein, that the Southern District of New York has already had considerable experience with this situation and is the most logical and convenient forum in which to bring

this class action. No difficulty is anticipated in managing this class action. Indeed, it is likely that the members of the class are more than satisfied to have someone take the initiative and incur the expense needed to try and salvage something from their investments.

First Count

7. Plaintiffs James E. Crane, James E. Crane, M.D., P.C., and James E. Crane and Mary Ellen Crane, Trustees of James E. Crane, M.D., P.C. Pension Trust (all of whom are herein also collectively referred to as "Crane") purchased limited partnership interests in Reading-Easton Associates (herein also called "Reading-Easton") and in Carlene Tower Associates (herein also called "Carlene"), and purchased a debenture in another limited partnership, Clementon Associates (herein also called "Clementon").

8. (a) Plaintiffs bring this

action on behalf of themselves and as a class action under FRCP 23 on behalf of all persons who purchased limited partnership interests or debentures or otherwise invested in Reading-Easton, Carlene, or Clementon.

(b) Members of the class are so numerous that joinder of all is impractical.

(c) Plaintiff's claims are typical of the claims of the members of the class, and plaintiffs undertake to adequately protect the interest of the class.

(d) There are questions of fact and law common to all members of the class and which predominate over questions affecting individual members.

(e) A class action is superior to other available methods for efficient adjudication of the causes of action.

9. As a result of the circumstances

alleged herein, Crane bought the following limited partnership interests: (a) A limited partnership interest in Reading-Easton was sold to Crane on or about November 15, 1972 for \$26,000. (b) A limited partnership interest in Carlene was sold to Crane on or about June 15, 1973 for \$13,000. (c) A debenture in Clementon was sold to Crane on or about January 1, 1974 for \$7,500.

10. All of the sales of limited partnership interests to Crane, and the sales of interests in those partnerships to all the other investors therein, as well as the solicitation and offer for sale of all those limited partnership interests, and the acts relating to such solicitation and offer and sale, were made by the use of means and instruments of interstate commerce or of the mails.

11. (a) Stonehenge Industries, Inc. ("Stonehenge") was a Delaware corpo-

ration engaged in organizing numerous limited partnerships, as real estate syndications in which investment interests were offered and sold to the public. Stonehenge, together with Anthony A. Constantine ("Constantine") and David A. Ward ("Ward"), acted as general partners of those limited partnerships. Constantine, Ward and Duncan Y. Henderson were officers and directors of Stonehenge.

(b) Howard N. Garfinkle ("Garfinkle"), himself or through organizations controlled by him, directly or indirectly sold the real properties to the partnerships here involved. Garfinkle was also the "wrap-around" mortgagee, referred to hereafter, to whom mortgage payments were made by those limited partnerships, and who was able, because of absence of protective arrangements with respect to that "wrap-around" mortgage, to misappropriate or otherwise improperly use those mortgage

payments. With respect to the allegations hereafter made, Garfinkle acted in collusion with Stonehenge, Constantine, Ward and Henderson, aided and abetted by the other defendants herein.

(c) Grayson Securities, Inc. ("Grayson Securities") and Arthur Grayson ("Grayson") were representatives of Stonehenge, selling interests in the aforesaid limited partnerships for funds received by Stonehenge, and for which Grayson and Grayson Securities received commissions or other payments from Stonehenge or the aforesaid limited partnerships. Grayson was the sole stockholder and chief officer of, and entirely controlled, Grayson Securities, which was registered as a broker-dealer under the Exchange Act and was a member of the National Association of Securities Dealers.

(d) Donald L. Lawrence ("Lawrence") is an attorney-at-law in New York

City, who advised Stonehenge, Constantine, Ward and Henderson in connection with the sale of the limited partnerships here involved, including but not limited to the preparation of circular material relating thereto and distributed in connection with those sales, and, with respect thereto, issued opinion letters for use in such sales. He also realized commissions or other payments in connection with sale of limited partnership interests in Stonehenge.

11a. Reading-Easton purportedly was intended to own and operate certain rental real estate at Reading, Pennsylvania and Easton, Pennsylvania; and the limited partnership interests in Reading-Easton were offered and sold as share investments in that enterprise. Carlene purportedly was intended to own and operate certain rental real estate at Philadelphia, Pennsylvania; and the limited partnership interests in Carlene were offered and sold

as share investments in that enterprise. Clementon purportedly was intended to own and operate certain rental real estate in Clementon, New Jersey; and the limited partnership interests in Clementon were offered and sold as share investments in that enterprise, and the debentures were issued as debt securities of that enterprise.

12. The organization of those limited partnerships, their acquisition of real estate, the literature issued by them to solicit investment in those partnerships, and the operation of those partnerships, was steeped in fraud and deception, to a degree that those partnerships were doomed to failure from the outset. Plaintiffs did not suspect the presence of such fraud or deception until 1975.

13. The fraud and deception worked

on the public in connection with those partnerships was so flagrant and widespread that the S.E.C. has obtained an injunction against those practices, enjoining Stonehenge from employing any fraudulent device, from obtaining money by untrue representations, and from engaging in the fraudulent offer and sale of securities.

14. This fraud and deception, and the accompanying solicitation and sale of interests in these partnerships, could not be perpetrated without the services and cooperation of professionals such as the defendant accountants and lawyers, who became an integral part of the web of concealment which kept the facts from the investors, as set forth hereafter.

15. At the very least, there were highly suspicious circumstances, as set forth below, that fraud and deception and significant irregularity were being prac-

ticed by controlling parties, with the purpose of soliciting and selling investments to the public in those partnerships. At the very least, those suspicious circumstances should have been investigated. Those suspicious circumstances, and the results of investigation, should have been disclosed. In fact, the defendant accountants and lawyers shut their eyes to those circumstances, and made no inquiry into them, and made no disclosure, and thereby aided and abetted the deceptive concealment worked on Crane and the other investors.

16. Numerous relevant and material circumstances were concealed from Crane and the other persons whose investments were solicited and obtained for those partnerships.

17. The limited partnership interests in each of Reading-Easton, Carlene and Clementon, and the debentures of Clementon,

were offered and sold to numerous investors in various states, including Illinois, Wisconsin, New York, Pennsylvania and Connecticut.

18. There were realized from such sales, in excess of \$350,000 for interests in Reading-Easton, in excess of \$350,000 for interests in Carlene, and in excess of \$450,000 for interests and debentures in Clementon, for a total of more than \$1,150,000 from all of which defendants profited directly or indirectly.

19. During the times that the aforesaid interests and debentures were being offered and sold, the S.E.C. took the position that such interests and debentures were securities, and in the aforesaid circumstances were required to be registered prior to offer and sale, in accordance with the Federal securities laws.

20. As professional promoters, investors, investment advisors, securities

brokers or dealers, attorneys, or accountants, defendants knew or should have known of the S.E.C. requirements with respect to the aforesaid interests and debentures, or willfully and recklessly disregarded the same, and should have disclosed or informed plaintiffs of same, but they failed and omitted to do so or to make any other disclosure thereof.

21. The aforesaid interests and debentures were securities, which were required to be registered under the Federal securities laws prior to their offer and sale, and the offer and sale in the absence of such registration was a violation of Federal law. All the defendants knew or should have known of the foregoing, or willfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

22. The real properties of Reading-

Easton, Carlene and Clementon were acquired directly or indirectly from Garfinkle or from organizations controlled by Garfinkle, and were acquired in circumstances and on terms and conditions involving collusion, and an absence of arms-length dealing, between Garfinkle, Stonehenge, Constantine, Ward and Henderson. All the defendants knew or should have known those facts, or willfully and recklessly disregarded the same, and failed and omitted to inform plaintiffs thereof or to make any other disclosure thereof.

23. At all times material hereto, Garfinkle had a criminal record, in substantial part involving charges or convictions of criminal violations relating to fraud and financial matters. All the defendants knew or should have known of those facts, or willfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs

thereof or to make any other disclosure thereof.

24. The aforesaid interests and debentures were offered and sold, and recommended, as "tax shelter" investments in income producing properties, acquired for the partnerships and managed honestly by responsible persons in a manner consistent with the best interests of the investors. In fact, the properties were purchased, financed, managed, sold and acquired in the interests of Garfinkle, Stonehenge, Constantine, Ward and Henderson, and for the profit or benefit of the defendants. All the defendants knew or should have known the foregoing, or willfully and recklessly disregarded the same, and nevertheless failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

25. During the period from or about January 1972 to February 1974, the

Stonehenge limited partnerships, including those involved herein, acquired substantially all of their properties from Garfinkle. Said properties had been purchased or contracted for by Garfinkle with little or no cash down payment, and, to the extent further funds were needed, Garfinkle obtained short-term, high interest, junior mortgage obligations which were placed against the properties. All the defendants knew or should have known those facts, or willfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

26. Garfinkle, Constantine, Ward and others caused the limited partnerships herein involved to acquire, at substantial markups from Garfinkle's purchase price, the properties obtained by these partnerships, by assuming all existing mortgages, paying off short term notes of Stonehenge

to Garfinkle, and entering into purchase money mortgages with Garfinkle or his nominees for other portions of the purchase price. As a result of the aforesaid mark-ups and debt burdens, said properties had insufficient cash flow and income to meet applicable obligations, or to return an income to plaintiffs. All the defendants knew or should have known, or willfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

27. Garfinkel, Constantine, and Ward created "wrap-around" mortgages for the properties of the limited partnerships involved herein, on terms which left the partnership mortgage payments and the fate of the partnerships' properties in Garfinkle's hands, without sufficient protection of the interests of the investors in the limited partnerships. Through those

"wrap-around" mortgages, Garfinkle controlled and determined whether, and the manner in which, the underlying mortgage obligations were paid and whether funds forwarded to him were used for that purpose. All the defendants knew or should have known those facts, or willfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

28. Escrow accounts were not set up for payment of the underlying mortgage obligations relating to the properties of the limited partnerships herein, and moneys paid to Garfinkle on those mortgage obligations were appropriated by him for other purposes. No control was exercised by Stonehenge or the persons controlling the partnerships over such moneys paid to Garfinkle, and he was delinquent or failed entirely to pay those obligations. All

the defendants knew or should have known those facts, or wilfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

29. Garfinkle directly and indirectly controlled the management and operation of the properties of the limited partnerships herein by entering into or engaging in (a) sale and leaseback arrangements with Stonehenge and (b) acting as "manager" or selecting or designating the persons who acted as "manager" of those properties. All the defendants knew or should have known those facts, or willfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

30. In 1972 and 1973, Garfinkle and Stonehenge and its officers arranged for pre-payment to Garfinkle of one year's interest on the underlying mortgage obligations relating to the properties of the

limited partnerships herein. These were sham transactions. Of the amounts thus paid to Garfinkle, as holder of the wrap-around mortgage, nothing was paid to the underlying mortgagees. All the defendants knew or should have known of the facts, or willfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

31. The properties of the limited partnerships herein have either been foreclosed or are in the process of foreclosure, causing plaintiffs to suffer serious financial loss.

32. The management of the properties of the limited partnerships here involved was of poor and inadequate quality, including, among other things insufficient maintenance, poor relations with tenants, and insufficient supervision of income and expense. All the defendants knew or should

have known the foregoing, or willfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

33. The management of the funds, assets, and records of the limited partnerships here involved was careless and reckless, involving waste, diversion of funds, and poor or inadequate record-keeping of the assets and income and expense of those partnerships. All the defendants knew or should have known the foregoing, or willfully and recklessly disregarded the same, and failed and omitted to inform plaintiffs thereof or to make any other disclosure thereof.

34. Stonehenge, as the general partner, and Constantine and Ward were indifferent and lax in managing the affairs of the limited partnerships here involved. All the defendants knew or should have

known the foregoing, or willfully and recklessly disregarded the same, and failed and omitted to disclose or inform plaintiffs thereof or to make any other disclosure thereof.

35. In acquiring properties for the limited partnerships here involved, Stonehenge and Constantine and Ward accepted information from Garfinkle about those properties, and relied on that information and used it in soliciting purchases by plaintiffs of interests in those partnerships, without verifying or adequately investigating that information. All the defendants knew or should have known the foregoing, or willfully and recklessly disregarded the same, and omitted to inform plaintiffs thereof or to make any other disclosure thereof.

36. The literature about the limited partnerships here involved, referred to refinancing in relation to the

properties of the partnerships. But such refinancing was improbable in view of the debt structure applicable to those properties and in view of the other circumstances hereinabove alleged. All the defendants knew or should have known the foregoing, or willfully and recklessly disregarded the same, and omitted to inform plaintiffs thereof or to make any other disclosure thereof.

37. As part of the effort to promote and sell shares or interests in the limited partnerships involved herein, defendants Stonehenge, Constantine, Ward, Lawrence, Grayson and Grayson Securities engaged in solicitation of investors and distributed offering circulars and brochures in connection therewith, all of which defendants Barth, Bergman and Barth, Pierson, Duel & Holland, and Ritch Greenberg & Hassan aided and abetted. With respect to such sales efforts and offering

circulars, there were false and misleading statements and false and misleading omissions concerning the following:

(a) Failure to indicate all the liens outstanding against the properties of the limited partnerships.

(b) Failure to indicate manipulation of obligations and mortgage indebtedness relating to the properties of the limited partnerships.

(c) Failure to indicate manipulation of the title to the properties which were supposed to be owned by the limited partnerships.

(d) False and misleading statements of income, expense, liabilities, cash flow, and/or equity build-up. Statements as to the profitability of the limited partnerships were inaccurate and were misrepresented.

(e) Failure to include in junior mortgages the provisions, in favor

of the investors, which the circulars stated would be put into the mortgage to the General Partner, even though the mortgage to the General Partner was replaced in whole or in part by such junior mortgages or by undisclosed increases in such junior mortgages.

(f) The absence of provisions in the wrap-around mortgage of protective provisions; failure to disclose the importance of honesty and integrity with respect to such wrap-around mortgage; and failure to disclose that no investigation had been made of the wrap-around mortgagee and the persons connected with the wrap-around mortgagee.

(g) Failure to disclose the prior owners of the properties acquired or to be acquired by the limited partnerships here involved, and the results of operations of those properties in prior years.

(h) False and misleading statements as to refinancing of the properties and a return of capital to the investors in the limited partnerships.

(i) Failure to indicate that the properties of the limited partnerships were not being acquired in arms-length transactions.

(j) Failure to disclose the commissions and other payments made or to be made to the defendants and others, and the payees thereof.

(k) Failure to disclose diversion and commingling of assets and funds of the limited partnerships.

(l) Failure to disclose mismanagement of the properties, assets, and funds of the limited partnerships.

38. Despite the occurrence of the foregoing with respect to limited partnerships already in existence or interests therein which had already been sold,

defendants continued to promote and offer and sell, or otherwise aid and abet the promotion and offer and sale, to further investors in those or similar limited partnerships, under substantially similar conditions and practices as applied to limited partnership interests already sold, without disclosure of those practices and conditions and in the presence of the same or similar false or misleading statements and omissions. Plaintiffs and other investors kept buying interests in those partnerships because of the foregoing failure of disclosure and because of those misleading statements and omissions.

39. If one or more of the defendants did not directly or indirectly commit or were not responsible for one or more of the acts or omissions hereinabove alleged, they aided and abetted the same. Plaintiffs did not know of any untruth or omission alleged hereinabove.

40. The facts set forth herein-
above, which defendants failed to disclose,
were material and plaintiffs would have
considered them important in making their
decision to invest in these partnerships,
if plaintiffs had known of them. If there
had been such disclosure, plaintiffs would
not have purchased their interests in
these partnerships.

41. The investments in Reading-
Easton, Carline, and Clementon were offered
for sale to the public, including plain-
tiffs, in a separate brochure prepared for
each of those partnerships, dated respec-
tively in October 1972, April 1973, and
October 1973. Those brochures were pre-
pared by defendants Leslie A. Barth;
Bergman and Barth; Pierson, Duel & Holland;
Ritch, Greenberg & Hassan; and Donald Law-
rence. Those brochures all have the omis-
sions of material facts and misleading
statements of material facts described in

pars. 19 through 38 hereof.

Second Count

42. The allegations in pars. 7 through 41 hereof are here incorporated by this reference to the same extent as if repeated here, and are alleged here with respect to the defendant Ritch, Greenberg & Hassan (herein also called the "Hassan firm").

43. The Hassan firm acted herein through Fouad M. Hassan, a partner of that firm acting within the scope of his authority.

44. The Hassan firm was a partnership of certified public accountants, who were the accountants for Stonehenge and also acted as the accountants for the limited partnerships involved herein. Their activities included the preparation of periodic accounting statements for Stonehenge and the limited partnerships during the years here in issue, and during those

years were involved in the record-keeping and the audits and supervision of the book-keeping and accounting records of Stonehenge and the limited partnerships.

45. The Hassan firm, as the accountants for Stonehenge and the limited partnerships, were aware of or knew, or should have inquired into and disclosed as alleged in par. 15 hereof, the misleading omissions and statements alleged in pars. 11 through 41 hereof.

46. The Hassan firm, as the accountants who serviced Stonehenge and the real estate operations of the partnerships, knew or had reasonable grounds to suspect the blatant deceptions that were being worked by Stonehenge, Garfinkle, Constantine and Ward, including the circumstances in which the partnerships obtained their properties, the arrangements made with respect to those properties, how those partnerships were being operated,

what was happening to the funds which came from investors, and what was happening to the assets, income and liabilities of the partnerships. All those facts were concealed from prospective investors and from purchasers of partnership interests because the Hassan firm consciously cooperated in keeping those facts concealed.

47. The Hassan firm prepared financial statements for Stonehenge and the partnerships herein at least for the years 1971 through 1974.

48. Brochures were distributed to prospective purchase of interests in each of the partnerships herein, including the plaintiffs, to induce them to invest in the partnerships.

49. At least the following facts should have been included in those brochures, in connection with the financial data prepared therefor by the Hassan firm, but the Hassan firm willfully or recklessly

failed to do so: pars. 20 and 21 (failure to register and meet S.E.C. requirements), par. 22 (lack of arms-length dealing and collusion in acquisition of properties), par. 24 (poor prospect of tax shelter), par. 25 (the debt burden against the acquired properties), par. 26 (insufficient cash flow to meet debt burden), par. 27 (lack of protection in wrap-around mortgage against misuse of mortgage payments), par. 28 (absence of excrow accounts for those wrap-around mortgage payments), par. 29 (sale and leaseback arrangements between Garfinkle of the partnerships' properties), par. 30 (sham pre-payment of interest) par. 33 (poor record-keeping by partnerships and diversion of their funds), par. 35 (failure to verify information received from Garfinkle about the properties), par. 36 (improbability of refinancing), par. 37(a) (failure to show all liens against the properties, par. 37(b) (failure

to indicate manipulation of obligations), par. 37(d) (false and misleading statements of income, expense, liabilities, profit, and equity build-up), par. 37(f) (wrap-around mortgage), par. 37(g) (failure to disclose prior owners of properties), par. 37(h) (misleading statements as to return of capital to investors), par. 37(i) (lack of arms-length dealing on properties), par. 37(j) (failure to disclose commissions taken by defendants), and par. 37(k) (failure to disclose commingling and diversion of assets and funds).

(The above references are to paragraphs in the complaint. The parenthetical description is only a short-hand reference; for the full description, see the cited paragraph).

50. The Hassan firm prepared financial statements (annexed hereto as Exhibits A, B and C) which were included with the foregoing brochures, and the

Hassan firm failed to disclose the foregoing facts in those financial statements, either as data therein or as notes thereto.

51. Annexed hereto as Exhibit A is a financial statement prepared by the Hassan firm for distribution to prospective investors in Reading-Easton with the brochure for that partnership. That statement purports to present "Actual" financial data. In fact, said data did not represent actual or historic information, derived from the operation of the property, but rather represented inaccurate artificially created figures obtained from Garfinkle (the seller of the property) and not verified by the Hassan firm. In these respects, and in deliberately or recklessly omitting to disclose those facts, that financial statement and the Hassan firm were deceptive and misleading.

52. Annexed hereto as Exhibits B and C respectively are financial statements

prepared by the Hassan firm for distribution to prospective investors in Carlene and Clementon respectively with the brochures for those partnerships. Those financial statements likewise were based on inaccurate artificial figures created by and received from Garfinkle rather than being based on actual performance of the properties, and the information underlying those statements had not been verified by the Hassan firm; and in deliberately or recklessly omitting to disclose those facts, those financial statements and the Hassan firm were deceptive and misleading.

53. Projections of income, profit, cash flow and other data likewise were prepared by the Hassan firm and distributed to prospective investors in Reading-Easton, Carlene and Clementon. Those projections were prepared for such distribution and likewise were based on artificially created figures and were false and misleading.

54. Neither Stonehenge nor the partnerships kept books which followed proper bookkeeping practice or accepted accounting principles. The Hassan firm knew those facts, but nevertheless deliberately or recklessly failed to state or reflect them in the foregoing financial statements or in the financial statements prepared by them for Stonehenge or the partnerships here involved.

55. Funds of the partnerships here involved were commingled with Stonehenge or other partnership funds, or were used to pay expenses other than those of the partnership to which the funds belonged. The Hassan firm knew those facts but nevertheless deliberately or recklessly failed to state or reflect them in the foregoing financial statements or in the financial statements prepared by them for Stonehenge or the partnerships here involved.

56. The Hassan firm reviewed and

participated in the preparation of the brochures or circulars intended for distribution and distributed to prospective investors in the partnerships here involved. Yet the Hassan firm made no attempt to disclose the foregoing relevant information.

57. The Hassan firm knew that there was not, and would not be, any registration with the S.E.C. of the investments sold in these syndications, and that the S.E.C. required such registration. Nevertheless, the Hassan firm deliberately omitted any information regarding S.E.C. registration in the financial statements prepared by them or in any of the circular material reviewed by them.

58. All the facts described hereinabove, and which the Hassan firm omitted to disclose, were material, and plaintiffs would have considered them important in making their decision to invest in these

partnerships if plaintiffs had known of them. If there had been such disclosure, plaintiffs would not have purchased their interests in these partnerships.

59. The affirmative misleading statements and information appearing in the brochures were relied on by plaintiffs in reaching their decision to invest in these partnerships.

60. In the material it prepared for use in soliciting investments in these partnerships, including the foregoing financial statements, the Hassan firm violated rules and standards of the American Institute of Certified Public Accountants ("AICPA").

61. AICPA statement on Auditing Standards No. 1 provides in Sec. 510.01:

"The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or in assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the

reasons therefore should be stated."

The Hassan firm did not comply with any of those requirements in connection with the financial statements it prepared for use in soliciting investors for the three partnerships involved here.

62. The Hassan firm obtained its information for the above financial statements from Garfinkle, as alleged above, but did not make that fact known. The failure to disclose that fact was a violation of AICPA standards. Thus, even where a financial statement is based on the report of another auditor (and certainly where it was based on information received from Howard N. Garfinkle), the AICPA requires in Statement on Auditing Standards No. 1, Sec. 14:

"When the auditor decides to make reference to the report of another auditor as a basis, in part, for his opinion, he should disclose this fact in stating the scope of his examination"

63. Indicating on the foregoing financial statements that they were "unaudited" or "pro forma" did not justify or excuse the foregoing misleading omissions or financial information by the Hassan firm. Thus, AICPA Statement on Auditing Standards No. 1, Sec. 516.06 requires:

"However, if the certified public accountant concludes on the basis of facts known to him that unaudited financial statements with which he may become associated are not in conformity with generally accepted accounting principles, which include adequate disclosure, he should insist . . . upon appropriate revision; failing that, he should set forth clearly his reservations in his disclaimer of opinion. The disclaimer should refer specifically to the nature of the reservations and to the effect, if known to him, on the financial statements." (Emphasis Added)

64. The Hassan firm further violated AICPA standards in not revising financial statements and information after they had been issued by it. Thus, AICPA Statement on Auditing Standards No. 1, Sec. 561, requires:

"When the auditor becomes aware of information which relates to financial statements previously reported on by him, but which was not known to him at the date of his report, and which is of such a nature and from such a source that he would have investigated it had it come to his attention during the course of his examination, he should, as soon as practicable, undertake to determine whether the information is reliable and whether the facts existed at the date of his report. In this connection, the auditor should discuss the matter with his client, at whatever management levels he deems appropriate, including the board of directors, and request cooperation in whatever investigation may be necessary.

* * *

"If the effect on the financial statements or auditor's report of the subsequently discovered information can promptly be determined, disclosure should consist of issuing, as soon as practicable, revised financial statements and auditor's report. The reasons for the revision usually should be described in a note to the financial statements and referred to in the auditor's report."

65. Under the AICPA standards, Hassan was required to make disclosure of

the omitted information and of the misleading information at least to plaintiffs and other investors, and to the S.E.C. The Hassan firm violated those standards of the AICPA. Thus, AICPA Statement on Auditing Standards No. 1, Sec. 561, requires:

"If applicable, the client should be advised to discuss with the Securities and Exchange Commission, stock exchanges, and appropriate regulatory agencies the disclosures to be made or other measures to be taken in the circumstances."

And, if the client fails to make disclosure, that same AICPA Standard, in Sec. 561.08, makes the following incumbent upon the accountant:

- "b. Notification to regulatory agencies having jurisdiction over the client that the auditor's report should no longer be relied upon.
- "c. Notification to each person known to the auditor to be relying on the financial statements that his report should no longer be relied upon. In many instances, it will not be practicable for the auditor to give appropriate individual notification

to stockholders or investors at large, whose identities ordinarily are unknown to him; notification to a regulatory agency having jurisdiction over the client will usually be the only practicable way for the auditor to provide appropriate disclosure. Such notification should be accompanied by a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure. The Securities and Exchange Commission and the stock exchanges are appropriate agencies for this purpose as to corporations within their jurisdictions."

66. The Hassan firm were conscious aiders and abettors of the fraud and deception and manipulation worked on purchasers of investments, including plaintiffs, in Reading-Easton, Carlene, and Clementon.

67. The Hassan firm aided and abetted the offer and sale of the investments in these partnerships by means of their prospectus (brochure) materials which included untrue statements of material facts necessary in order to make those

prospectus materials not misleading, as alleged above, and plaintiffs did not know of any such untruths or omissions at the time they purchased their investments in these partnerships. Plaintiffs hereby tender those investments to the Hassan firm in return for the amounts they paid therefore, with interest thereon.

Third Count

67a. The allegations in pars. 7 through 41 hereof are here incorporated by this reference to the same extent as if repeated here, and are alleged here with respect to defendant Pierson, Duel & Holland (herein also called the "Duel firm").

68. The Duel firm acted herein through Arthur Duel, a partner of that firm acting within the scope of his authority.

69. The Duel firm was a law firm at Darien, Connecticut, specializing in real estate matters.

70. During the years here in issue, the Duel firm was counsel to Stonehenge and to the limited partnership involved here.

71. The Duel firm prepared the organization papers of the three limited partnerships involved here.

72. The Duel firm represented Stonehenge in the acquisition of the real properties which were syndicated through these partnerships. Thus, the Duel firm participated in the negotiations which preceded the acquisition of these properties by Stonehenge and their transfer to the limited partnerships; the Duel firm became familiar with the title condition of those properties; the Duel firm became familiar with the debt against those properties; the Duel firm participated in the preparation of or otherwise became familiar with the various mortgage notes, bonds and mortgage instruments (including the

wrap-around mortgage to Garfinkle), deeds, assignments, and miscellaneous underlying documents.

73. Arthur Duel, the partner of the Duel firm involved here, also served as Vice-President and Assistant Secretary of Stonehenge.

74. The Duel firm participated in the preparation and review of the brochures intended for distribution, and distributed, to prospective investors in the partnerships involved here, as alleged hereinabove in par. 41. The Duel firm nevertheless willfully or recklessly failed to insert the material facts which were omitted, or to correct the misleading statements, referred to in pars. 19 through 38 hereof.

75. The Duel firm was aware of or knew, or should have inquired into and disclosed as alleged in par. 15 hereof, all the misleading omissions and statements alleged in pars. 11 through 41

hereof, but it willfully or recklessly failed to do so.

76. The Duel firm knew that the purpose of the property acquisitions and the formation of the partnerships was to solicit investments by the public in those properties under the circumstances described heretofore. The Duel firm knew, or should have known and willfully and recklessly disregarded, the fraudulent circumstances which accompanied that public solicitation. Under the federal securities laws, the Duel firm had a duty to take steps to make the material information (relating to the solicited investments) available to prospective investors or to the S.E.C.

77. The Duel firm violated its duty, under the federal securities laws, in remaining silent and making no attempt at disclosure of the misleading omissions and misleading statements alleged herein-

above; and the Duel firm thereby consciously cooperated in aiding and abetting the fraudulent and deceptive solicitation and sale of these investments.

78. The Duel firm was in a position to know, and in fact knew or deliberately shut its eyes to, the following, as to none of which the Duel firm made any attempt at disclosure:

(a) The Stonehenge properties were all acquired from Garfinkle, under terms consistently favorable to Garfinkle, with an absence of arms-length dealing and involving collusion (Par. 22).

(b) The Duel firm was familiar with the "wrap-around" mortgage and the absence of protective provisions therein against Garfinkle (Par. 27, 28). The Duel firm knew that the properties had been acquired by Garfinkle with little cash, and was overloaded with debt, which was passed on to Stonehenge and the limited

partnerships (Par. 25, 26). The Duel firm knew, or shut its eyes to, the debt on the real estate acquired from Garfinkle by Stonehenge and the limited partnerships, and the substantial increases in the sales prices over Garfinkle's purchase prices (within a short period), which resulted in insufficient cash flow and income to meet obligations (Par. 26).

(c) The Duel firm knew or should have known of all the liens outstanding against the properties; and yet, knowing that the properties were being syndicated, it took no steps at all to have the investors informed of those liens (Par. 37(a)).

(d) Similarly Pars. 37(b), (c), (d) and (i) deal with matters affecting the real properties which the Duel firm knew or should have known, and as to which it took no steps to make any disclosure.

79. The real estate involved in the limited partnerships was acquired by Stonehenge and the partnerships over a period of several years. During that period, in the face of existing circumstances, interests were being sold to investors. During that period, the Duel firm had continuing contact with the Stonehenge situation and the partnerships, and was in a position to see and know the mismanagement and manipulation that was taking place with respect to the real estate and the partnerships, but the Duel firm made no disclosure of the same. Thus:

(a) The Duel firm was involved in the organization of the Carlene limited partnership and the Reading-Easton limited partnership in 1972.

(b) The real estate of the Clementon limited partnership was acquired in 1973, and the Duel firm was involved in that acquisition.

80. The brochures distributed to prospective purchasers to solicit investment in these partnerships, failed to set forth the information and coverage required by the S.E.C. for the offer and/or sale of interests in real estate limited partnerships. The Duel firm, in view of its position with Stonehenge and the partnerships, was responsible for, and either knew or recklessly disregarded, the misleading nature of those brochures.

81. All the facts described hereinabove, and which the Duel firm omitted to disclose, were material and plaintiffs would have considered them important in making the decision to invest in these partnerships if plaintiffs had known of them. If there had been such disclosure, plaintiffs would not have purchased their interests in these partnerships.

82. In addition to the foregoing, the Duel firm undertook to act as agent

for the purchasers of debentures of Clementon, and the soliciting literature distributed for Clementon contained a statement to that effect. That literature stated in reference to the Clementon debentures: "The mortgage will be held by Pierson, Duel and Holland, attorneys-at-law, Darien, Connecticut, as agent for the debenture holders." (Emphasis Added)

83. Plaintiffs understood, from that soliciting literature for Clementon, that the Duel firm would act as agent for Clementon debenture holders, and, relying on that literature and the representation of the agency of the Duel firm, purchased their debenture in Clementon.

84. Acting in the capacity of agent for the Clementon debenture holders, the Duel firm had the duty, under the federal securities laws, to disclose all misleading omissions and misleading statements applicable to Clementon, as alleged

herein with respect to Clementon and the other two partnerships involved herein. That duty included inquiry into, and disclosure of, omitted or distorted material facts of which it was put on notice by the information which it had and into which it should have made inquiry.

85. With respect to its undertaking to act as agent for the debenture creditors of Clementon, the Duel firm should have acted to also disclose to prospective purchasers its ties and relations with Stonehenge and the debtor partnership, and its resulting conflicting position.

86. The Duel firm willfully and recklessly did not make any of those disclosures to the prospective purchasers of Clementon debentures or in any other manner.

87. All of the foregoing information regarding the position of the Duel

firm as agent for the Clementon debenture holders, was material and plaintiffs would have considered that information important in making their decision to invest in those debentures if plaintiff had that information. If there had been such disclosure, plaintiffs would not have invested in those debentures.

88. The Duel firm were conscious aiders and abettors of the fraud and deception and manipulation worked on purchasers, including plaintiffs, in Reading-Easton, Carlene, and Clementon.

89. The Duel firm aided and abetted the offer and sale of the investments in those partnerships by means of prospectus materials (the brochures referred to in par. 41 hereof) which included untrue statements of material facts and omitted material facts necessary in order to make the prospectus materials not misleading, as alleged above, and plaintiffs did not

know of any such untruths or omissions at the time they purchased their investments in these partnerships. Plaintiffs hereby tender those investments to the Duel firm in return for the amounts they paid therefor, with interest thereon.

Fourth Count

89a. The allegations in pars. 7 through 41 hereof are here incorporated by this reference to the same extent as if repeated here, and are alleged with respect to defendants Bergman & Barth, P.C. and Leslie A. Barth (herein collectively called the "Barth firm").

90. The Barth firm acted herein through its partners Leslie A. Barth and Stanley Bergman, who acted within the scope of their authority.

91. The Barth firm was a law office at New Haven, Connecticut, experienced in securities and tax matters.

92. The Barth firm advised

Stonehenge, Constantine, Ward and Henderson in connection with the sale of the limited partnership interests here involved, including but not limited to securities matters and the preparation of brochure material relating thereto and distributed in connection with such sales, and, with respect thereto, issued tax opinion letters for use in such sales.

93. The Barth firm participated in the preparation of offering literature for distribution to prospective purchasers of interests in the partnerships here involved (par. 41 above), including Clementon, and prepared a tax opinion letter annexed to that literature. A copy of that tax opinion is annexed hereto as Exhibit D.

94. The Barth firm made the following deceptive misleading omissions and statements in the foregoing brochure and tax opinion:

a. Preparation of literature for circulation to prospective investors without disclosing that the S.E.C. required registration of the offer, issuance and sale of those securities.

b. Preparation of literature for circulation to prospective investors without disclosing that the offer, issuance, and sale of those securities were required to be registered under the federal securities laws.

c. Preparation of literature for circulation to prospective investors without indicating that Stonehenge Industries, Inc. had failed to register under Connecticut securities laws, and that the offer, issuance and sales of those securities violated Connecticut law.

d. Failure to disclose in such literature that registration would not be made as aforesaid.

e. Failure to disclose in

such literature the statutory and/or regulatory authorities under which registration would not be made.

f. Preparation of literature for circulation to prospective investors without disclosing that Stonehenge Industries, Inc. was in violation of Connecticut law by doing business in Connecticut without qualifying to do business in Connecticut.

g. Failure to include in aforesaid literature the following information as to all unregistered securities in real estate syndications organized or promoted by Stonehenge Industries, Inc., Anthony A. Constantine and/or David Ward during the years 1971 through 1973:

(i) The date of sale, and title and amount of such securities sold.

(ii) The persons to whom such securities were sold.

(iii) As to securities sold for cash, the aggregate offering price and the aggregate commissions or discounts paid or given on such sales.

(iv) The section of the federal securities statutes and the Rule of the S.E.C. under which exemption from registration was claimed; and the facts relied upon to make the exemption available.

h. Failure to include in such literature, with respect to the Clementon limited partnership interests and the Clementon debentures, the information in par. g(iv) above.

i. Failure to furnish with such literature, a copy of the partnership agreement for Clementon.

j. Failure to furnish an opinion of counsel supporting the tax matters and consequences as to the partnership's activities or proposed activities

described in such literature.

k. With respect to the property purchased by Stonehenge Industries, Inc. and the partnership, failure to include in such literature the following:

(a) The cost of such property to the seller, and the aggregate depreciation claimed by the seller within five years prior to the transaction. (b) The principle or method used in determining the buyer's purchase price, and the name of the person making such determination.

l. Failure to state in such literature the commissions paid or payable with respect to the purchase of the property b- Stonehenge and the partnership.

m. Failure to state in such literature the commissions paid or payable with respect to the sale of the limited partnership interests and the debentures in the syndication.

n. Failure to disclose in

such literature that the property sold to Clementon, together with all other properties acquired by Stonehenge and all the syndications promoted by it, were acquired from Garfinkle.

o. Failure to disclose in such literature that the property purchases, referred to in par. 14 hereof, were bought in circumstances of collusion, lacking arms-length dealing between Garfinkle and Stonehenge and its officers and directors.

p. Failure to disclose in such literature that Garfinkle had a criminal record at the time of the purchase of the property by Stonehenge and Clementon, as well as at the times of purchase of all other properties bought by the other syndications promoted by Stonehenge, and that such criminal record involved charges or convictions relating to fraud and financial matters.

q. Failure to disclose in

such literature that the partnership interests and debentures in Clementon were unsatisfactory as tax shelter investments because the offering was being made for the benefit of Garfinkle and Stonehenge and the principals of Stonehenge, and not for the benefit of the investors.

r. Failure to disclose in such literature that Garfinkle acquired the Clementon property, as well as all other properties bought from him by Stonehenge and the syndications promoted by it, with little or no cash down payment, and, to the extent further cash was needed by Garfinkle, he obtained the same through short-term, high interest, junior mortgages placed against those properties.

s. Failure to disclose in such literature that Garfinkle was selling the properties, acquired by Stonehenge and the syndications it promoted, at substantial markups and subject to extensive debt

burdens, which would result in insufficient cash flow and income to meet obligations or return an income to the investors.

t. Failure to disclose in such literature that the wrap-around mortgage placed on the Clementon property, and given to Garfinkle as mortgagee, did not include any provision for escrow or other arrangement which would safeguard proper use by Garfinkle of payments made to him for the purpose of paying mortgage debt.

u. Failure to disclose in such literature that Garfinkle would and did, directly or indirectly, control the management of the Clementon property as well as the properties of the other Stonehenge syndications.

v. Failure to disclose in such literature that in 1972 and 1973 Garfinkle had obtained pre-payment of interest on the wrap-around mortgages on properties of other Stonehenge syndications, but he

did not use those funds to pay the underlying mortgagees.

w. Failure to disclose in such literature that the information presented therein, about the property purchased by the syndication and the financial data, had been obtained from Garfinkle and had not been verified or investigated.

x. Failure to disclose in such literature historical data and financial information about the past record of the property sold to Clementon.

y. Failure to disclose in such literature that, in view of the foregoing circumstances, refinancing of the property was improbable.

z. Failure to make the disclosures, and the misrepresentations, set forth in pars. 37 through 41 hereof.

aa. Failure to set forth in such literature the information and coverage required by the S.E.C. for the offer

and/or sale of interests in real estate limited partnerships.

bb. Failure to set forth in that literature, as risks for the investors, the risks and problems flowing from the aforesaid circumstances.

cc. Issuance of the tax opinion by the Barth firm, appended to the foregoing literature, which was improper because the Barth firm were not independent tax counsel.

dd. Issuance of the tax opinion, appended to the foregoing literature, which failed to take into account the circumstances set forth above.

ee. Issuance of the tax opinion based on the assumption that "the partnership's activities will be conducted in accordance with the terms of the Partnership Agreement," whereas (a) defendants Barth firm knew or should have known that such assumption was contradicted or made

questionable by the foregoing circumstances, and/or (b) said defendants should have but did not investigate to determine whether it was reasonable or proper to make such assumption.

ff. Failure to set forth in the tax opinion, or elsewhere in the offering literature, the federal tax consequences concerning the matters described in Securities and Exchange Commission Release No. 10663 (March 1, 1974).

gg. Failure to disclose in the tax opinion that the Internal Revenue Service would refuse to issue a determination letter or a ruling in this situation, or would issue an unfavorable determination letter or ruling in this situation, regarding the federal income tax treatment of the partnership and the investors.

hh. Failure to disclose in the tax opinion or elsewhere in the literature, that on April 30, 1973, the U. S.

Treasury Department and the federal administration had presented to Congress the Tax Reform Bill of 1973, which would significantly alter the tax treatment of the partnership and the investors as presented in the offering literature and tax opinion.

ii. Failure to present in the tax opinion or elsewhere in the literature, the income tax treatment to the investors in the event of bankruptcy or loss of the partnership assets, as in fact happened here, and, in particular, the effect on the investors of the reduction in their liabilities as a result of such events.

jj. Failure to present in the tax opinion or elsewhere in the literature, the risk of denial by Internal Revenue Service of deductions of the partnership arising prior to the purchase by an investor of an interest in the partnership.

kk. Failure to verify and determine, in issuing the tax opinion or

such literature, whether Stonehenge had the minimum net worth required by the Internal Revenue Service for issuance of a determination or ruling recognizing the partnership as a limited partnership.

ll. Failure to disclose the risk that the Internal Revenue Service would not recognize the partnership as a limited partnership because of the insufficient net worth of the general partners.

mm. Failure to disclose the risk in the tax opinion or elsewhere, that, in the presence of manipulation and collusion in the acquisition of the properties, and in view of manipulation and collusion in partnership operation, between Garfinkle and Stonehenge, there was a risk that the Internal Revenue Service would not recognize the sales price by Garfinkle as the tax basis for the partnership.

nn. Failure to disclose the risk in the tax opinion or elsewhere, that,

in view of par. mm above, Internal Revenue Service would not recognize or accept a deduction by the partnership or the investors for depreciation figured on such tax basis or in the amounts set forth in the offering literature.

oo. Failure to disclose the risk in the tax opinion or elsewhere, that shifting percentage in profits and gains on sale, as between the general partners and the limited partners, that the limited partners would have additional income by reason of the reduction in their proportionate share of partnership liabilities, under reasoning such as appears in Rev. Rul. 74-40, C.B. 1974-1, p. 159.

pp. Failure to disclose the risk in the tax opinion or elsewhere, that the nonrecourse debt running from the general partners to the limited partners or to the partnership will be treated as a capital contribution to the partnership

rather than as debt, pursuant to Rev. Rul. 72-135, C.B. 1972-1, p. 200.

qq. The erroneous statement in the offering literature that the "effective date of the tax law traditionally goes back no further than the date the bill is reported out of committee" (emphasis added), without indicating the risk of other retroactive dates, which have been used in federal tax laws, such as the date a provision is presented by the Treasury Department or the date a committee first publicizes the provision.

rr. Failure to disclose to investors in the tax opinion or elsewhere, that prudence and protection of investors required that a determination or ruling from the Internal Revenue Service be applied for, with respect to the tax treatment of the partnership and the investors.

ss. Failure to disclose the foregoing in any other manner, other than

in such literature or in the tax opinion.

tt. Creating the impression for investors, in the tax opinion and in such literature, that the partnership and the investors would receive "favorable" tax treatment.

uu. Making available the tax opinion and the use of the professional names as aid in inducing the sale of investments in the partnership.

vv. Failure to disclose that the Securities and Exchange Commission would oppose the sale of securities in the circumstances of this situation, and would act to enjoin or otherwise prevent such sale.

ww. Failure to disclose the risk that at least some significant portion of the so-called interest payable on the wrap-around mortgage to Garfinkle would be denied as a deduction to the investors.

95. The Barth firm knew, and intended, what their tax opinion and brochure would be used to solicit investments in these partnerships.

96. The Barth firm owed a duty to plaintiffs under the federal securities laws, not to issue deceptive misleading tax opinions and misleading brochures for the aforesaid purpose.

97. All the omissions described above, as a result of which the brochures and tax opinion were misleading, were material, and plaintiffs would have considered them important in making the decision to invest in these partnerships if they had known of them. If there had been such disclosure, plaintiffs would not have purchased their interests in these partnerships.

98. All misleading statements described above were material and were relied on by plaintiffs in deciding to purchase their interests in these partnerships.

99. The Barth firm were conscious aiders and abettors of the fraud and deception and manipulation worked on purchasers, including plaintiffs, in Reading-Easton, Carlene, and Clementon.

100. The Barth firm aided and abetted the offer and sale of the investments in these partnerships, and particularly in Clementon, by means of prospectus materials which included untrue statements of material facts and omitted material facts necessary in order to make the prospectus materials not misleading, as alleged above, and plaintiffs did not know of any such untruths or omissions at the time they purchased their investments in these partnerships. Plaintiffs hereby tender those investments to the Barth firm in return for the amounts they paid therefor, with interest thereon.

Fifth Count

101. The allegations of pars. 7

through 100 hereof are here incorporated by this reference to the same extent as if repeated here with respect to Grayson and Grayson Securities.

102. At all times material hereto, Grayson and Grayson Securities were registered broker-dealers, or controlled a registered broker-dealer, under the federal securities acts.

103. Grayson and Grayson Securities recommended to plaintiffs that they purchase their investments in these partnerships, without disclosing to plaintiffs the misleading omissions and statements alleged hereinabove, and received commissions for arranging the sale of those investments to plaintiffs on the basis of those misleading omissions and statements.

104. Grayson and Grayson Securities are liable to plaintiffs under the federal securities laws for participating in the sales to plaintiffs as aforesaid,

and for aiding and abetting the sales of those investments to plaintiffs on the basis of said misleading omissions and statements.

105. In addition to the violations of the federal securities laws alleged hereinabove, Grayson and Grayson Securities have violated Exchange Act §15(c) and Rule 10b-3, in that, by the use of the mails or means or instrumentalities of interstate commerce to effect a transaction or to induce the purchase or sale of a security otherwise than on a national security exchange, they engaged in a manipulative, deceptive, or fraudulent act or practice or devise.

106. If Grayson or Grayson Securities did not directly or indirectly commit or were not responsible for one or more of the acts or omissions within Exchange Act 15(c) or Rule 10b-3, they aided and abetted the same.

107. Grayson and Grayson Securities used the prospectus materials referred to in the Second, Third and Fourth Counts hereof to offer and sell investments in the partnerships herein.

108. Grayson and Grayson Securities aided and abetted the offer and sale of the investments in these partnerships by means of prospectus materials which included untrue statements of material facts and omitted material facts necessary in order to make the prospectus materials not misleading, as alleged above, and plaintiffs did not know of any such untruths or omissions at the time they purchased their investments in these partnerships. Plaintiffs hereby tender those investments to Grayson and Grayson Securities in return for the amounts they paid therefor, with interest thereon.

Sixth Count

109. The allegations of pars. 7

through 41 hereof are here incorporated by this reference to the same extent as if repeated here with respect to defendant Donald L. Lawrence ("Lawrence").

110. Donald L. Lawrence participated in the preparation of the brochures referred to in par. 41 hereof, and he rendered written tax opinions which were attached to the brochures for Reading-Easton and Carlene and which were dated respectively October 12, 1972 and April 2, 1973.

111. The allegations in pars. 90 through 100 hereof with respect to the Barth firm are here, by this reference, repeated and alleged with respect to Lawrence.

112. Lawrence likewise aided and abetted the sales of these investments to plaintiffs by means of prospectus materials with false and misleading omissions and statements, as alleged above, and plaintiffs

did not know of any such untruths or omissions at the time of those sales. Plaintiffs hereby tender those investments to Lawrence in return for the amounts paid therefor, with interest thereon.

Seventh Count

113. The allegations of pars. 7 through 41 hereof are here incorporated by this reference with the same effect as if here repeated in full with respect to the respective defendants to the same extent as set forth above.

114. The acts and omissions hereinabove alleged were committed recklessly, wantonly, and/or willfully by defendants.

115. The omissions and acts hereinabove alleged were committed by defendants with intent to deceive plaintiffs with respect to the offer of these investments to plaintiffs and their purchase of these investments.

116. The omissions and acts here-

inabove alleged were committed by defendants with intent to aid and abet the violations of the federal securities laws.

Eighth Count

117. The allegations of pars. 7 through 41 hereof are here incorporated by this reference with the same effect as if here repeated in full with respect to the respective defendants to the same extent as set forth above.

118. The false representations made by defendants, as more fully set forth above, were known by defendants to be false or were made wantonly or recklessly without regard to their truth. Those representations were made to enable the sale of the investments in the limited partnerships here involved, and without registration of the same with the S.E.C., and particularly to induce plaintiffs to buy such interests. Plaintiffs believed and relied on those representations, to their damage suffered

herein.

Ninth Count

119. The allegations of pars. 7 through 41 hereof are here incorporated by this reference with the same effect as if here repeated in full with respect to the respective defendants to the same extent as set forth above.

120. Defendants owed plaintiffs a duty to make accurate representations as to the matters referred to hereinabove, and to make representations with respect thereto which were not misleading.

121. Defendants failed to take reasonable care with respect to the representations made by them and with respect to the matters as to which they failed to make disclosure to plaintiffs, as alleged hereinabove.

122. Plaintiffs purchased their interests in the partnerships herein involved as a result of the negligent repre-

sentations and omissions of defendants, causing the damage suffered by plaintiffs.

Tenth Count

123. The allegations of pars. 7 through 41 hereof are here incorporated by this reference with the same effect as if here repeated in full with respect to the respective defendants to the same extent as set forth above.

124. Defendants Stonehenge, Constantine, Henderson, Grayson and Grayson Securities, and the Duel firm stood in the relation of fiduciaries to plaintiffs, and, by reason of the circumstances alleged hereinabove, breached their fiduciary duty to plaintiffs.

Eleventh Count

125. The allegations of pars. 7 through 41 hereof are here incorporated by this reference with the same effect as if here repeated in full with respect to the respective defendants to the same

extent as set forth above.

126. The Duel firm, as agent for the debenture holders of Clementon, breached its obligations and duties to plaintiffs, in failing to inform them of material facts, which they knew or should have ascertained, relating to those debentures before and after purchase of the same by plaintiffs.

Prayer for Relief

Plaintiffs pray that judgment be entered in their favor against defendants for the following:

1. The amount each plaintiff invested in the limited partnerships here involved, including the purchase price and expense in buying interests (including debentures) in those partnerships.
2. Interest on those investments from the date of such investments.
3. Reasonable attorney and accounting fees.

4. Three times the amount of plaintiffs' investment as exemplary damages.

5. Accounting by defendants of all monies and assets realized by them as a result of the sales of partnership interests to plaintiffs, and payment of all such monies and assets into a fund held by the court for payment of damages to plaintiffs.

6. Costs of this action.

7. That this action proceed as a class action and that the court direct or authorize giving of appropriate notice to all members of the classes herein.

8. Such other and further relief as may be just and proper in law or in equity.

Dated: New York, New York
December 20, 1976

/s/ Tobias Weiss

Tobias Weiss

Attorney for Plaintiffs

c/o Barry Doft, Esq.

70 Pine Street

New York, New York 10005

483-1750

READING - EASTON ASSOCIATES
RECEIPTS & DISBURSEMENTS SCHEDULE

| | Actual (Unaudited) 1972 | Pro Forma 1973 |
|---------------------------|-------------------------------|----------------------|
| <u>Income</u> | | |
| Apartment Rental | \$275,284 | \$291,250 |
| Less Vacancy | 10,851 | 11,510 |
| Net Rental Income | 264,433 | 279,740 |
| Laundry Income | 4,404 | 4,404 |
| Total Income | \$268,837 | \$284,144 |
| <u>Operating Expenses</u> | | |
| Real Estate Taxes | \$ 37,980 | \$ 37,980 |
| Water & Sewer | 14,600 | 14,600 |
| Gas heat | 23,340 | 23,340 |
| Insurance | 4,340 | 4,340 |
| Electricity | 8,500 | 8,500 |
| Pool Expense | 1,500 | 1,500 |
| Repairs & Maintenance | 12,000 | 12,000 |
| Payroll & Management | 20,000 | 21,000 |
| Total Operating Expenses | \$122,260 | \$123,260 |
| Net Operating Income | \$146,577 | \$160,884 |
| Less Debt Service | 112,052 | 125,598 |
| Net Cash Flow | \$ 34,525 | \$ 35,286 |

EXHIBIT A

CARLENE ASSOCIATESRECEIPTS & DISBURSEMENTS SCHEDULEPRO-FORMA 1973INCOME

| | |
|--------------------|---------------|
| Apartment Rentals: | \$315,000 |
| Less Vacancy: | <u>11,000</u> |
| Net Rental Income: | 304,000 |
| Laundry Income: | 3,500 |
| Pool Income: | <u>9,000</u> |
| Total Income: | \$316,500 |

EXPENSES

| | |
|--------------------------|----------------|
| Taxes: | \$ 31,188 |
| Heat & Hot Water: | 12,850 |
| Electric: | 29,000 |
| Water and Sewer: | 6,084 |
| Insurance: | 5,000 |
| Pool: | 1,500 |
| Garbage: | 3,000 |
| Repairs and Supplies: | 4,000 |
| Maintenance: | 11,000 |
| Payroll and Management: | <u>22,420</u> |
| Total Operating Expense: | \$126,042 |
| Net Operating Income: | 190,458 |
| Less Debt Service: | <u>146,550</u> |
| Net Cash Flow: | \$ 43,908 |

EXHIBIT B

SCHEDULE D

CLEMENTON ASSOCIATES

Receipts and Disbursements Schedule
Pro-Forma 1973

Income:

| | |
|-------------------|---------------|
| Apartment Rental | \$265,000 |
| Less Vacancy | <u>10,000</u> |
| Net Rental Income | 255,000 |
| Laundry Income | <u>3,900</u> |
| Total Income | \$258,900 |

Operating Expenses:

| | |
|--------------------------|---------------|
| Taxes | \$ 53,671 |
| Water | 3,200 |
| Sewer | 11,880 |
| Electric | 4,200 |
| Insurance | 3,500 |
| Garbage | 2,400 |
| Maintenance | 9,000 |
| Pool | 800 |
| Payroll and Management | <u>18,000</u> |
| Total Operating Expenses | \$106,651 |

| | |
|-----------------------|----------------|
| Net Operating Income: | \$152,249 |
| Less Debt Service | <u>114,375</u> |
| Net Cash Flow | \$ 37,874 |

EXHIBIT C

BERGMAN and BARTH, P.C.
ATTORNEYS AT LAW

900 Chapel Street
New Haven, Connecticut 06510

(203) 777-6211

October 25, 1973

Stonehenge Industries, Inc.
45 East Putnam Avenue
Greenwich, Connecticut

CLEMENTON ASSOCIATES

Dear Sirs:

We refer to the Agreement of Limited Partnership (the "Partnership Agreement") of Clementon Associates (the "Partnership") dated as of October 1, 1973 to be entered into among Stonehenge Industries, Inc., a Delaware corporation, and A. A. Constantine, as general partners (the "General Partners"), and certain investors as Limited Partners (the "Limited Partners"). This opinion is being delivered to you in connection with the admission to the Partnership of the limited partners.

We have examined such documents as we have deemed relevant or necessary for the purpose of this opinion, and in rendering this opinion we have assumed that the General Partners and each of the Limited Partners will have full power, authority and local right to enter into and perform the terms of the Partnership Agreement, that the Partnership Agreement will be duly executed and delivered by or

EXHIBIT D

on behalf of the General Partners and each Limited Partner, that an amended and restated Certificate of Limited Partnership in the form examined by us will be duly filed and that the Partnership's activities will be conducted in accordance with the terms of the Partnership Agreement.

Based on the foregoing and on the relevant Federal income tax laws and regulations as currently interpreted by the Internal Revenue Service, the Partnership will be classified as a partnership for Federal income tax purposes within the meaning of section 7701(a)(2) and subchapter K of chapter 1 of the Internal Revenue Code of 1954, as amended (the "Code") and sections 301.7701-2 and -3 of the current Treasury Regulations. If such regulations or interpretations are amended, the treatment of the Partnership and the partners for Federal income tax purposes may be altered for the taxable years affected thereby. The present Internal Revenue Service interpretations of these provisions of the Code and the regulations are subject to change at any time and we understand that the Treasury Department may in the future propose certain amendments to such regulations. The Internal Revenue Service has recently adopted a policy whereby it may refuse to issue advance rulings as to whether an organization will be classified as a partnership unless the general partners share at least 5% of the earnings and losses of the partnership, which policy has been duly considered by us in rendering this opinion.

Very truly yours,
BERGMAN AND BARTH, P.C.

By: /s/ Leslie R. Barth
Leslie R. Barth

APPENDIX BAmendment of Par. 12 of Complaint
to Constitute Par. 12a

12a. Plaintiffs did not suspect the presence of such fraud or deception until 1975. Plaintiff James E. Crane (Dr. Crane) is engaged in an extensive and very busy practice of medicine, with respect to which he is helped by his wife Mary Ellen Crane (Mrs. Crane). Neither have any business or financial experience. Not having received an interest payment on a syndication bond, they wondered about the financial condition of Clementon, without thinking at all about fraud or deception. Mrs. Crane therefore phoned Attorney Tobias Weiss on December 5, 1977, at Stamford, Connecticut, and asked him to make inquiry into the safety of their investments in the Stonehenge syndications. The attorney made inquiries, as a result of which he

learned that a bankruptcy proceeding involving Stonehenge had been filed in the southern district of New York. The attorney went to the clerk's office of that bankruptcy court the following day, December 6, 1974, and learned that the S.E.C. had intervened in that proceeding. The attorney then phoned the S.E.C. to inquire as to the steps contemplated by the S.E.C., and was told that a meeting would be held on the Stonehenge situation at the S.E.C. office in New York City on January 17, 1975, at 3:30 P. M., and, as a representative of an investor, the attorney was told that he could attend that meeting. Thereafter, after obtaining the approval of Mrs. Crane, the attorney in fact did attend that meeting, and was informed there that the S.E.C. had investigated Stonehenge and found fraudulent practices in connection with its syndications under the securities laws. On the

following Monday, January 20, 1975, the attorney met with Mrs. Crane and informed her of the information obtained at the S.E.C. meeting. Prior to the S.E.C. meeting of January 17, 1975, plaintiffs had no basis on which to assert claims of fraud against Stonehenge or any of the defendants; and prior to December 9, 1974, plaintiffs had no information that the S.E.C. was involved in any way in the Stonehenge situation.

APPENDIX C

U. S. DISTRICT COURT
FILED
JUL 6 1977
4:36 PM
S. D. OF N. Y.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- - - - - x

JAMES E. CRANE, et al., :

Plaintiffs, :

-against-

75 Civ. 5995
(CMM)

STONEHENGE INDUSTRIES, INC., : #46126
et al., :

Defendants. :

- - - - - x

METZNER, D. J.:

Plaintiffs move pursuant to Fed. R.
Civ. P. 15(a) for an order allowing them
to amend the second amended complaint.

Paragraph 12 of the second amended
complaint contains the statement: "Plain-
tiffs did not suspect the presence of such
fraud or deception until 1975." It is

quite apparent that such an allegation does not satisfy the requirement that a party allege the time and circumstances of discovery of a fraud when bringing an action more than one year after the sale of a security based upon Section 12(2) of the Securities Act of 1933 (15 U.S.C. § 771(2)). In re Caesars Palace Securities Litigation, 360 F. Supp. 366, 377 (S.D.N.Y. 1973). Plaintiffs seek to cure this defect by the proposed amendment.

It is well established that leave to amend shall be freely given, Foman v. Davis, 371 U.S. 178 (1962), especially so that matters can be determined on the merits of the case and not because of mispleading by one of the parties, United States v. Houghman, 364 U.S. 310, 317 (1960). The information contained in the proposed amendment has previously been filed in this action in either briefs or affidavits. Allowing plaintiffs to amend

the complaint will not prejudice any of the defendants. Accordingly, this motion to amend paragraph 12 of the second amended complaint is granted.

So ordered.

Dated: New York, N. Y.
July 1, 1977

CHARLES M. METZNER
U. S. D. J.

APPENDIX D

U. S. DISTRICT COURT
FILED
JUL 6 1977
4:36 PM
S. D. OF N. Y.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- - - - - x

JAMES E. CRANE, et al., :

Plaintiffs, :

-against-

75 Civ. 5995
(CMM)

STONEHENGE INDUSTRIES, INC., : #46127
et al.,

Defendants.

- - - - - x

METZNER, D. J.:

Defendant Ritch, Greenberg & Has-
sen, an accounting firm, moves, pursuant
to Fed. R. Civ. P. 9(b), 12(b)(1) and (6),
for an order dismissing the second amended
complaint (the complaint).

The original complaint in this ac-
tion was dismissed for failure to plead

with particularity as required by Fed. R. Civ. P. 9(b), with leave to file an amended complaint. The amended complaint suffered from the same deficiency and was dismissed as to this defendant, with leave to file a second amended complaint. This latter pleading is the subject of this motion.

Defendant is charged in count II of the complaint with having violated the securities laws of the United States. It is alleged that defendant was the accountant for defendant Stonehenge Industries, Inc. and for the limited partnerships, which are the subject matter of the alleged fraud. In this capacity it is alleged that defendant prepared financial statements with knowledge that they were to be distributed with promotional material regarding various limited partnership agreements. These financial statements, attached to the complaint as Exhibits A, B and C, were

neither certified by the defendant nor identified with the defendant in any way.

There is no specification as to how these financial statements are false and a reading of them shows that the alleged omissions were not required to be included in order to make them complete for their intended purpose. What plaintiff alleges is that since defendant prepared these financial statements, it must have had knowledge of all the wrongdoing allegedly perpetrated in this case. This is not enough to hold defendant liable to plaintiffs.

The allegations regarding these financial statements are totally conclusory and without factual foundation. E.g., "In fact, said data did not represent actual or historic information . . . but rather represented inaccurate artificially created figures" Complaint, ¶ 51. Such a pleading fails to

comply with Fed. R. Civ. P. 9(b). A pleading alleging fraud must specifically state in what respect the financial statements were inaccurate, and not merely allege in a conclusory manner that they were inaccurate. Rich v. Touche Ross & Co., 68 F.R.D. 243 (S.D.N.Y. 1975).

Defendant is also charged with participating in the preparation and review of promotional brochures which were used to induce plaintiffs into buying the allegedly fraudulent limited partnerships and debentures. Complaint, ¶ 56. There are no factual allegations as to what specifically this defendant did in reviewing or preparing the brochures; there is merely the plaintiffs' conclusion that defendant did so.

Plaintiffs have also included in this complaint eight paragraphs alleging violation by this defendant of the rules and standards of the American Institute of

Certified Public Accounts (AICPA), in the preparation of the financial statements and other promotional material. Since the allegations as to the financial statements and to the brochures are themselves deficient, allegations as to specific AICPA rules cannot cure the complaint.

As this court has pointed out to plaintiffs on numerous occasions: "A complaint alleging fraud should be filed only after a wrong is reasonably believed to have occurred; it should serve to seek redress for a wrong, not to find one." Segal v. Gordon, 467 F.2d 602, 607-08 (2d Cir. 1972).

Accordingly, this motion is granted and the complaint as to this defendant is dismissed with prejudice for failure to plead with particularity as required by Fed. R. Civ. P. 9(b).

So ordered.

Dated: New York, N. Y.
July 1, 1977

CHARLES M. METZNER
U. S. D. J.

APPENDIX E

U. S. DISTRICT COURT
 FILED
 JUL 6 1977
 4:36 PM
 S. D. OF N. Y.

UNITED STATES DISTRICT COURT
 SOUTHERN DISTRICT OF NEW YORK

- - - - - x

JAMES E. CRANE, et al., :

Plaintiffs, :

-against- : 75 Civ. 5995
 : (CMM)

STONEHENGE INDUSTRIES, et al., : #46123

Defendants. :

- - - - - x

METZNER, D. J.:

Defendant Pierson, Duel & Holland
 (defendant), a law firm, moves pursuant to
 Fed. R. Civ. P. 9(b), 12(b)(1) and (6),
 12(c), 56 and 11, for an order dismissing
 the second amended complaint (the complaint)
 and for other relief.

Fed. R. Civ. P. 9(b) states: "In
 all averments of fraud or mistake, the cir-

cumstances constituting fraud or mistake shall be stated with particularity." This is the third time that the court has been presented with a motion to dismiss a complaint in this action on the grounds that plaintiffs have failed to comply with this rule regarding the law firm. Twice before this court had to grant such a motion, and once again it finds the complaint must be dismissed because of this same insufficiency.

While plaintiff has facially rearranged the complaint to allege the claims against movant in a separate count, the allegations contain no greater specificity than before. For example, in paragraph 14 it is alleged:

"This fraud and deception, and the accompanying solicitation and sale of interests in these partnerships, could not be perpetrated without the services and cooperation of professionals such as defendant accountants and lawyers"

In paragraph 15 it is alleged:

"At the very least, there were highly suspicious circumstances . . . that fraud and deception and significant irregularity were being practiced by controlling parties In fact, the defendant accountants and lawyers shut their eyes to those circumstances, and made no inquiry into them, and made no disclosure, and thereby aided and abetted the deceptive concealment worked on Crane and the other investors."

Plaintiffs further allege that they were induced to buy an interest in various limited partnerships as a result of offering brochures and circulars that contained numerous material false and misleading statements as well as omissions. E.g., "False and misleading statements of income, expense, liability, cash flow, and/or equity buildup. Statements as to the profitability of the limited partnerships were inaccurate and were misrepresented." Paragraph 37(d). "False and misleading statements as to refinancing of the properties and a return of capital to the investors

in the limited partnerships." Paragraph 37(h). There is no indication as to which of the various brochures and circulars contained these false statements, what the statements were, why they were false, or who were responsible for them. These are not statements of fact, merely conclusions and therefore insufficient to satisfy Rule 9. Shemtab v. Shearson, Hammill & Co., 448 F.2d 442 (2d Cir. 1971).

It is apparent from a reading of this complaint that the heart of this alleged fraud was the preparation and distribution of various brochures and circulars and material omissions in them. Plaintiffs have failed to allege any set of facts that tie this defendant to the preparation of those brochures. The bald assertion contained on paragraph 41 that "[t]hose brochures were prepared by defendants Leslie A. Barth; Bergman and Barth; Pierson, Duel & Holland; Ritch, Greenberg

& Hassan; and Donald Lawrence" is not sufficient. It gives no notice to this defendant as to what specifically it is alleged to have done wrong. It is exactly this type of joint accusation which forced the court in Lincoln National Bank v. Lampo, 414 F. Supp. 1270, 1278 (N.D. Ill. 1976), to dismiss the complaint in that case.

Furthermore, even assuming that this defendant had knowledge of various facts that plaintiffs have alleged to have been omitted from the brochures, as enumerated in paragraph 37, the complaint fails to state a claim against this defendant. "[M]ere possession and non-disclosure of material facts does not alone create liability under Rule 10b-5; there must be, in addition, some relationship which generates a duty to inform." Gold v. DCL, Inc., 399 F. Supp. 1123, 1127 (S.D.N.Y. 1973). Plaintiffs have failed to establish any

relationship between this defendant and the preparation of the questionable brochures, and thus there can be no liability for failure to disclose.

Finally, defendant again moves for an award of costs, expenses and attorney's fees, pursuant to Fed. R. Civ. P. 11. This motion is denied. The court adheres to its decision of September 7, 1976, when it disposed of this issue in regard to the first amended complaint. The fact that the court has dismissed the second amended complaint as to this defendant does not significantly alter the situation.

The inability to comply with Rule 9(b) after three attempts requires dismissal with prejudice as to this defendant.

So ordered.

Dated: New York, N. Y.
July 1, 1977

CHARLES M. METZNER
U. S. D. J.

APPENDIX F

U. S. DISTRICT COURT
FILED
JUL 15 1977
S. D. OF N. Y.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

- - - - - x

JAMES E. CRANE, et al., :

Plaintiffs, :

-against-

75 Civ. 5995
(CMM)

STONEHENGE INDUSTRIES, INC., : #46159
et al., :

Defendants.

- - - - - x

METZNER, D. J.:

Defendants Bergman and Barth, P.C.,
a law firm, and Leslie Barth, a member of
that firm, move pursuant to Fed. R. Civ.
P. 9(b), 12(b)(1) and (6) and 12(c) for an
order dismissing the second amended com-
plaint (the complaint).

The original complaint in this ac-
tion was dismissed as to these defendants

on May 26, 1976 for failure to plead with particularity as required by Fed. R. Civ. P. 9(b), with leave to file an amended complaint. The amended complaint was dismissed as to these defendants by order of this court dated November 29, 1976, with leave to file a second amended complaint. This latter complaint is the subject of this motion.

Defendants are charged in the fourth count of the complaint with having violated the securities laws of the United States. It is alleged that defendants helped prepare brochures and other literature which were used to sell to plaintiffs interests in various limited partnerships, which are the subject of the alleged fraud. It is further alleged that these brochures were false, misleading and contained material omissions.

Fed. R. Civ. P. 9(b) states "In all averments of fraud or mistakes the

circumstances constituting fraud or mistake shall be stated with particularity." This rule has been strictly enforced especially in securities fraud complaints where professionals have been named as defendants.

"Rule 9(b)'s specificity requirement stems not only from the desire to minimize the number of strike suits but also more particularly from the desire to protect defendants from the harm that comes to their reputations or to their goodwill when they are charged with serious wrongdoing:

It is a serious matter to charge a person with fraud and hence no one is permitted to do so unless he is in a position and is willing to put himself on record as to what the alleged fraud consists of specifically." Segal v. Gordon, 467 F.2d 602, 607 (2d Cir. 1972).

In this complaint plaintiffs have failed to allege facts with any particularity as to these defendants. The allegations as to the brochures and offering literature are purely conclusory and do not specify

exactly what these defendants are alleged to have done. There are no allegations as to what statements in the brochures were false, why they were false, or who individually was responsible for the statements. These types of conclusory allegations are insufficient to support a fraud complaint. Shemtob v. Shearson, Hammil & Co., 448 F.2d 442 (2d Cir. 1971).

Plaintiffs further allege that besides participating in the preparation of the brochures and offering literature, these defendants also issued a tax opinion letter which was included with the brochures and offering literature. This tax opinion letter is specifically identified and attached to the complaint as an exhibit. However, plaintiffs have failed to allege specifically how this tax opinion letter is false or misleading. It appears that plaintiffs have brought this action on the theory that since defendants pre-

pared a standard tax opinion letter, they must have known of all the wrongdoing allegedly perpetrated in this case. A reading of the tax opinion letter makes it clear that none of the alleged wrongdoing had to be known by movants in order to make the tax opinion letter complete for its intended purpose.

Accordingly, this motion is granted and the complaint as to these defendants is dismissed with prejudice.

So ordered.

Dated: New York; N. Y.
July 15, 1977

CHARLES M. METZNER
U. S. D. J.

APPENDIX G

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Court-house in the City of New York, on the fifth day of January one thousand nine hundred and seventy-eight.

Present:

HON. IRVING R. KAUFMAN,
Chief Judge.

HON. WILLIAM H. TIMBERS

HON. THOMAS J. MESKILL,
Circuit Judges,

JAMES E. CRANE; JAMES E. CRANE,
M.D., P.C.; and JAMES E. CRANE and
MARY ELLEN CRANE, Trustees of
JAMES E. CRANE, M.D., P.C. PENSION
TRUST (on behalf of themselves and
investors similarly situated),
Plaintiffs-Appellants,

v.

STONEHENGE INDUSTRIES, INC.;
ANTHONY A. CONSTANTINE; DAVID A.
WARD; DUNCAN Y. HENDERSON; HOWARD
N. GARFINKLE; ARTHUR GRAYSON;
GRAYSON SECURITIES, INC.; DONALD

) 77-7393

/s/ William H. Timbers
WILLIAM H. TIMBERS

/s/ Thomas J. Meskill
THOMAS J. MESKILL,
Circuit Judges.

APPENDIX H

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventeenth day of February, one thousand nine hundred and seventy-eight

Present: HON: IRVING R. KAUFMAN
HON: WILLIAM H. TIMBERS
HON: THOMAS J. MESKILL

Circuit Judges.

JAMES E. CRANE, et. al.)

Plaintiffs-Appellants)

vs.)

77-7393)

STONEHENGE INDUSTRIES, INC.,)
et al.,)

Defendants-Appellees)

A petition for a rehearing having been filed herein by counsel for the appellants

Upon consideration thereof, it is
Ordered that said petition be and
hereby is denied.

A. Daniel Fusaro
Clerk

By: /s/ Ida G. Smyer
Ida G. Smyer
Staff Attorney

UNITED STATES COURT OF APPEALS
FILED
FEB 17 1978
A. DANIEL FUSARO, CLERK
SECOND CIRCUIT

APPENDIX IThe Wrap-Around Mortgage

A wrap-around mortgage was given to Garfinkle on each property acquired by the syndications.

All the properties had debt against them, running to other creditors, when they were acquired by Garfinkle. When he sold the properties to Stonehenge for syndication, which was very shortly after he acquired them, he added even further debt to the properties, the latter debt running to him or to organizations controlled by him. That was done through the "wrap-around" arrangement, under which he was given a mortgage for the entire outstanding debt--both that created to him and that owed to the other creditors.

Thus, assume that there was an existing mortgage on a property when it was acquired by Garfinkle. He then added

debt to the property, but took a mortgage in an amount which equalled the total of the debt to him and the debt to others. In other words, the purchase money mortgage to him "wrapped around" the prior debt.

Under this arrangement, the syndications made principal and interest payments to Garfinkle on that entire debt, both that running to him and that running to other creditors. It remained for Garfinkle to use the appropriate portions of those payments to pay the other creditors. If he failed to do so, there would be a default on the other mortgages with resulting foreclosure, even though the syndications had made the payment to Garfinkle. In fact, there was such foreclosure because he did not make the required remittance to the other creditors.

Under such an arrangement, it was most important that the wrap-around mortgage

have safeguards to assure remittance to the other creditors of their portion of the amounts paid to Garfinkle. That was the importance of an escrow of those funds. In fact, there was no provision made for an escrow or for any other protective measure in this regard.

Supreme Court, U. S.

FILED

JUN 16 1978

MICHAEL RODAK, JR., CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1977
No. 77-1638

JAMES E. CRANE; JAMES E. CRANE, M.D., P.C.; and JAMES
E. CRANE and MARY ELLEN CRANE, TRUSTEES OF JAMES
E. CRANE, M.D., P.C. PENSION TRUST (on behalf of them-
selves and investors similarly situated),

Petitioners,

v.

LESLIE A. BARTH; BERGMAN AND BARTH, P.C.; PIERSON, DUEL
& HOLLAND; and RITCH, GREENBERG & HASSAN,

Respondents.

**BRIEF OF
RESPONDENTS BERGMAN AND BARTH, P.C.
AND LESLIE A. BARTH IN OPPOSITION
TO PETITION FOR A WRIT OF CERTIORARI**

ROBERT E. SMITH
80 Pine Street
New York, New York 10005
*Attorney for Respondents
Bergman and Barth, P.C. and
Leslie A. Barth*

Of Counsel:

GUGGENHEIMER & UNTERMYER
80 Pine Street
New York, New York 10005

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1977
No. 77-1638

JAMES E. CRANE; JAMES E. CRANE, M.D., P.C.; and JAMES
E. CRANE and MARY ELLEN CRANE, TRUSTEES OF JAMES
E. CRANE, M.D., P.C. PENSION TRUST (on behalf of them-
selves and investors similarly situated),

Petitioners,

v.

LESLIE A. BARTH; BERGMAN AND BARTH, P.C.; PIERSON, DUEL
& HOLLAND; and RITCH, GREENBERG & HASSAN,

Respondents.

**BRIEF OF
RESPONDENTS BERGMAN AND BARTH, P.C.
AND LESLIE A. BARTH IN OPPOSITION
TO PETITION FOR A WRIT OF CERTIORARI**

This brief is submitted in opposition to plaintiffs' petition for a writ of certiorari. Plaintiffs seek review of the judgment of the United States Court of Appeals for the Second Circuit entered on January 5, 1978 which affirmed the judgment of the United States District Court for the Southern District of New York dismissing the second amended complaint on the ground that it fails to meet the requirements of Fed. R. Civ. P. 9(b). Respondents Bergman and Barth, P.C. and Leslie A. Barth oppose the issuance of a writ of certiorari because of the lack of any conflict of decision with other courts of appeal, the absence of any issue of significance in the administration of the

federal securities laws and the fact that the decision below was clearly correct.

Respondents Bergman and Barth, P.C. and Leslie A. Barth are attorneys, as are respondents Pierson, Duel & Holland. Respondents Ritch, Greenberg & Hassan are accountants. All of the respondents are hereinafter collectively referred to as the "professional defendants".

Question Presented

The question presented by the petition for a writ of certiorari is: did the United States Court of Appeals for the Second Circuit abuse its discretion in affirming dismissal of the second amended complaint against the professional defendants on the ground that it failed to allege fraud with the particularity required by Fed. R. Civ. P. 9(b)?

Statement of the Case

1. Nature of This Action and the Parties

This action was commenced on November 26, 1975 by the filing of a complaint alleging violations of § 17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77q(a), §§ 10(b), 15(c) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), o(c) and t(a), respectively, and S.E.C. Rules 10-b, 10b-5 and 15c 1-2. The first amended complaint added an alleged violation of Securities Act § 5, 15 U.S.C. § 77e, which later was abandoned. The second amended complaint added an alleged violation of § 12(2) of the Securities Act, 15 U.S.C. § 77l(2).

The only federal claims presently asserted by plaintiffs are under § 10(b) of the Exchange Act, and §§ 12(2) and

17(a) of the Securities Act. (4)* Plaintiffs also have asserted claims, relying on pendent jurisdiction, for reckless, wanton and/or willful acts and representations by defendants; negligent representations, and breach of fiduciary relationship.

The plaintiffs are Dr. James E. Crane, individually, as a trustee of his pension trust and as a professional corporation, and his wife, Mary Ellen Crane, as trustee of Dr. Crane's pension trust. Plaintiffs seek to recover losses allegedly sustained on their limited partnership investments in three real estate tax shelters. The nature and date of purchase of these interests were as follows:

a) a limited partnership interest in Reading-Easton Associates—purchased on November 15, 1972 for \$26,000. (10a)**

b) a limited partnership interest in Carlene Tower Associates—purchased on June 15, 1973 for \$13,000 (*id.*); and

c) a debenture issued by Clementon Associates purchased on January 1, 1974 for \$7,500. (*Id.*)

The defendants are: the corporation which formed the limited partnerships and sold interests therein to the public—Stonehenge Industries, Inc. ("Stonehenge"); the officers and directors of Stonehenge—Messrs. Constantine, Ward and Henderson; Howard N. Garfinkle, who allegedly sold real estate properties to Stonehenge and improperly obtained and misappropriated funds from Stonehenge; the sales representatives of Stonehenge—Grayson Securities, Inc. and Arthur Grayson; and every lawyer and accountant

* References are to pages of the Petition for a Writ of Certiorari unless otherwise indicated.

** References designated ("—a") are to pages of the Appendix filed by petitioners.

who rendered any professional services to Stonehenge including Ritch, Greenberg & Hassan ("Hassan") certified public accountants; Donald L. Lawrence, an attorney; Pierson, Duel & Holland, attorneys; and Leslie A. Barth and Bergman and Barth, P.C., attorneys.

2. Prior Proceedings

Defendants Hassan and Pierson, Duel & Holland moved to dismiss the original complaint on several grounds including plaintiffs' failure to comply with Fed. R. Civ. P. 9(b) and their failure to state a claim upon which relief can be granted. The original complaint was dismissed on May 27, 1976 with leave to replead. An amended complaint was filed on June 14, 1976 but it was as deficient as the original and new motions to dismiss were filed.

On September 7, 1976 the District Court dismissed the amended complaint as to Pierson, Duel & Holland, stating that it "fails utterly to set forth a specific fact from which it could be concluded that there is a connection between the defendant law firm and the alleged wrongful conduct" and that it lacked the specificity mandated by Rule 9(b).

On September 23, 1976 and November 30, 1976 the amended complaint also was dismissed as to Hassan and Leslie A. Barth and Bergman and Barth, P.C., respectively, on Rule 9(b) grounds.

Thereafter, plaintiffs moved for reconsideration of the dismissals and for leave to file a second amended complaint. Leave was granted and a second amended complaint was filed on December 20, 1976. That complaint proved to be a rehashed version of its predecessors and defendants were compelled to move once again. This time the District Court granted the motions, with prejudice, noting that although "facially rearranged" the third complaint contained "no greater specificity than before". (108a) The

complaints relating to Hassan, Bergman & Barth, P.C. and Leslie A. Barth similarly were dismissed on Rule 9(b) grounds. (101a-106a and 113a-117a)

The Court of Appeals affirmed the judgments of dismissal on the basis of the District Court's decision. (119a-120a)

3. Analysis of the Second Amended Complaint*

The very first sentence of the complaint signals its insufficiency through the statement that each and every allegation is upon information and belief except paragraphs 1-10. The complaint is not accompanied by any statement of the facts upon which the belief is founded.

The first ten paragraphs of the complaint, the only allegations made with knowledge, refer to jurisdiction (¶ 1); claimed violations of §§ 12 and 17(a) of the Securities Act, and § 10 of the Exchange Act (¶ 2), as well as other claimed violations of the securities laws in the sale of limited partnership interests through Stonehenge which are no longer in issue; venue (¶ 3); the appropriateness of class action certification under Fed. R. Civ. P. 23 (¶ 4); the applicability of the factual allegations to all plaintiffs (¶ 5); the composition and common interests of the class (¶ 6); the identity of the plaintiffs and the limited partnerships in issue (¶ 7); assertions by plaintiffs of their commencement of the action as a class action (¶ 8); identification of the specific purchases by Crane, and the dates and amounts of these purchases (¶ 9), and allegations that sales and solicitations were made by use of the mails (¶ 10).

All of the remaining allegations, as summarized below, are pleaded on information and belief.

* The Second Amended Complaint appears at pages 1-94 of the Appendix.

The complaint alleges that Stonehenge organized limited partnerships as real estate syndications which were offered and sold to the public; that Stonehenge, Constantine and Ward were general partners and that Constantine, Ward and Henderson were officers and directors of Stonehenge (§ 11(a)); that Garfinkle sold the properties acquired by the limited partnerships, became the "wrap around mortgagee" and was able to misappropriate mortgage payments; that he colluded with Stonehenge, Constantine, Ward and Henderson, and that he "was aided and abetted by the other defendants herein" (§ 11(b)). There follows a description of defendants Grayson Securities and Grayson (§ 11(c)) and Donald Lawrence, Esq. (§ 11(b)).

The complaint then describes the purpose of the three limited partnerships—to acquire and operate real estate (§ 11a)—and claims that the organization, operation and sale of the limited partnerships were steeped in fraud and deception and that the fraud led to an S.E.C. injunction against such practices (§ 12). The complaint *carefully omits* the uncontested fact that the S.E.C. never took action against or enjoined any of the professional defendants.

Paragraphs 14 and 15 constitute the crux of plaintiffs' complaint. They restate the theme found in the amended and original complaints and in the instant Petition. (16) Both paragraphs reveal that the claim against the professional defendants is based on supposition rather than fact. Plaintiffs claim, in *res ipsa loquitur* fashion, that the fraud in the sale of the limited partnerships "could not be perpetrated without the services and cooperation of professionals such as the defendant accountants and lawyers" (§ 14); that "[a]t the very least, there were highly suspicious circumstances [that] should have been investigated" (§ 15); and that the "defendant accountants and lawyers

shut their eyes to those circumstances, and made no inquiry into them, and made no disclosure, and thereby aided and abetted the deceptive concealment worked on Crane and the other investors." *Id.*

The manner in which the fraud occurred is set forth following allegations that relevant information was concealed from plaintiffs (§ 16); that limited partnership interests were offered to numerous investors in various states; that substantial monies were realized on such sales (§§ 17, 18), and that the S.E.C. had asserted a requirement for registration prior to such sales (§ 19).

The complaint then recites a litany of supposed facts and events which all of the defendants "knew or should have known" or "willfully and recklessly disregarded," and as to which there was no disclosure. *It is noteworthy that all of these allegations involved acts, misrepresentations and omissions of Stonehenge, its officers and Garfinkle. None involved any of the professional defendants.*

The allegations are that the professional defendants should have known of the requirements asserted by the S.E.C. (§ 20); that the sale of the limited partnership interests constituted unlawful sales of securities (§ 21); that the properties acquired by Stonehenge from Garfinkle involved collusion and the absence of arm's length negotiations (§ 22); that Garfinkle had a criminal record (§ 23); that although the securities were offered as "tax shelter investments" in honestly managed entities, the real properties were acquired, sold and managed for the benefit of Garfinkle, Stonehenge and its officers (§ 24); that Garfinkle obtained properties for little or no cash, and by placing junior mortgages against the properties (§ 25); that Stonehenge paid Garfinkle substantially more for the properties than he had paid (§ 26); that Stonehenge assumed various

mortgages so that the properties produced insufficient cash flow for debt service (*id.*); that by using a "wrap around mortgage" granted to him, Garfinkle controlled the manner in which junior mortgages were paid (§ 27); that no escrow fund was set up (§ 28); that Stonehenge exercised no control over the properties, and that Garfinkle misappropriated funds earmarked for the payment of mortgages (*id.*); that Garfinkle controlled the management and operation of the properties through certain agreements and arrangements (§ 29); that Stonehenge prepaid certain interest payments to Garfinkle which he did not use to pay junior mortgages (§ 30); that the properties purchased by plaintiffs were being foreclosed or had been foreclosed, and that the plaintiffs had suffered serious financial losses (§ 31); that the properties were poorly managed (§ 32); that the limited partnerships were poorly managed and their funds wasted (§§ 33, 34); that Stonehenge and its officers accepted information from Garfinkle with respect to the properties without independent verification which information Stonehenge in turn relied on and used for the purpose of soliciting investors (§ 35); and that Stonehenge issued literature that referred to non-existent financing possibilities. (§ 36). Once again we pause to emphasize that all of these charges, whether or not true, have absolutely no relationship to any acts taken by the professional defendants.

Paragraph 37 of the complaint makes plain that the professional defendants played no part in the solicitation or sales of securities and never distributed any offering brochures. That was done by Stonehenge, its officers and its sales representatives. Plaintiffs merely state, generally, that the efforts of Stonehenge were "aided and abetted" by "defendants Barth, Bergman and Barth, Pierson, Duel & Holland and Ritch, Greenberg & Hassan". (§ 37).

Although paragraph 37 lists all of the ways in which the sales efforts and circulars were false and misleading, *there is not the slightest specification of how the professional defendants aided and abetted*. The most that plaintiffs ever have said is that the professional defendants shut their eyes to those circumstances, made no inquiry and made no disclosure (§ 15). There are general allegations in paragraph 41 that *all* of the professional defendants prepared *all* of the offering brochures for *all* of the investments in Reading-Easton, Carlene and Clementon.

I.

The Decision of the United States Court of Appeals for the Second Circuit Affirming Dismissal of the Complaint is Clearly Correct.

Fed R. Civ. P. 9(b) states in relevant part:

"In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity."

Rule 9(b) has been vigorously enforced, especially where securities law fraud is alleged against professionals such as attorneys or accountants. *Segal v. Gordon*, 467 F.2d 602, 607 (2d Cir. 1972); *Shemtob v. Shearson, Hammill & Co.*, 448 F.2d 442, 444 (2d Cir. 1971); *O'Neill v. Maytag*, 339 F.2d 764, 768 (2d Cir. 1964). As the court held in *Segal v. Gordon*, *supra*, 467 F.2d at 607:

"Rule 9(b)'s specificity requirement stems not only from the desire to minimize the number of strike suits but also more particularly from the desire to protect defendants from the harm that comes to their reputa-

tions or to their goodwill when they are charged with serious wrongdoing:

It is a serious matter to charge a person with fraud and hence no one is permitted to do so unless he is in a position and is willing to put himself on record as to what the alleged fraud consists of specifically. [footnote omitted]

• • •

... 'Mere conclusory allegations to the effect that defendant's conduct was fraudulent or in violation of 10b-5 are insufficient [citations omitted];' '[m]ere general allegations that there was fraud, corruption or conspiracy or characterizations of acts or conduct in these terms are not enough no matter how frequently repeated [citations omitted].'

It is widely recognized that this rule is essential if the law is to protect professionals from being slandered by premature and unfounded general accusations—from suits brought prior to any meaningful investigation. The requirements of Rule 9(b) are "necessary to safeguard potential defendants from lightly made claims charging commissions of acts that involve some degree of moral turpitude." 5 Wright & Miller, *Federal Practice and Procedure*, § 1296 at 339.

As stated in *Sloan v. Canadian Javelin, Ltd.*, CCH Fed. Sec. Law Rep. (1973-74 Transfer Binder), ¶ 94, 579 at p. 96,033 (S.D.N.Y. 1974): "Because allegations of fraud made against accountants and others whose business depends on clients' trust and confidence can threaten their entire professional status, Rule 9(b) requires that plaintiffs set forth more completely than in an ordinary complaint the factual circumstances that allegedly entitle them

to relief. [Citations omitted]" In *Rich v. Touche Ross & Co.*, 68 F.R.D. 243, 245 (S.D.N.Y. 1975) the court stated:

"The requirement that allegations of fraud be pleaded with particularity stems from, among other sources, a concern that potential defendants be shielded from lightly made public claims or accusations charging the commission of acts or neglect of duty which may be said to involve moral turpitude. C. Wright & A. Miller, *Federal Practice and Procedure*, § 1296. *The need for this protection is most acute where the potential defendants are professionals whose reputations in their field of expertise are most sensitive to slander.* See *Felton v. Walston and Co., Inc.*, 508 F.2d 577, 581-582 (2d Cir. 1974). Apart from the prejudicial and in *terrorem* effects of fraud allegations a defendant in a fraud action requires particularized information in order to understand what conduct is complained of and to prepare a defense to such a claim of misconduct." (Emphasis supplied)

In *Rich* the complaint alleged that an accountant had (a) certified false and misleading financial statements; (b) failed to disclose violations of the federal securities laws by Weis [the defunct brokerage house]; (c) failed to disclose violation of the net capital rule and more specifically Rule 325 of the New York Stock Exchange; (d) certified false financial reports; (e) certified and prepared inaccurate financial statements; and (f) failed to disclose that it had certified and filed with the SEC false financial reports. 68 F.R.D. at 246. The court stressed the rule particularly applicable to this case—that it is not sufficient merely to list a series of alleged wrongs. The crucial allegations are "the time, place and content of the false misrepresentation, the fact misrepresented and what was obtained or given up as a consequence of the fraud". 2A

J. Moore, Federal Practice ¶9.03" *Id.* The court concluded that the defendant should at least be apprised of what the plaintiff must prove in order to meet its burden:

"In order to sustain their burden of proof on the merits of their claim, *plaintiffs will have to demonstrate that they relied upon false statements made by Touche Ross or that omissions fraudulently made by those accountants were the cause of plaintiffs' damages.* . . . [I]t is not an unreasonable burden to expect the plaintiffs to be able to identify the misstatements, omissions or fraud that caused them to engage in particular securities transactions." [Citation omitted; emphasis supplied]. 68 F.R.D. at 247.

Similarly, in *Gross v. Diversified Mortgage Investors*, 431 F. Supp. 1080, 1087 (S.D.N.Y. 1977), the court articulated the rationale behind Rule 9(b)'s specificity requirement:

"There are at least three well-recognized purposes for Rule 9(b)'s specificity requirement. The first is to inhibit the filing of a complaint as a pretext for discovery of unknown wrongs. *Segal v. Gordon, supra* at 607-08; *Lewis v. Varnes*, 368 F. Supp. 45, 47 (S.D. N.Y.), *aff'd*, 505 F.2d 785 (2d Cir. 1974). A complaint alleging fraud 'should serve to redress a wrong, not to find one.' *Segal v. Gordon, supra* at 608. The second aim is to protect potential defendants from the harm that comes to their reputations when they are charged with the commission of acts involving moral turpitude. *Segal v. Gordon, supra* at 607; *Rich v. Touche Ross & Co.*, 68 F.R.D. 243, 245 (S.D.N.Y. 1975). Finally, Rule 9(b) serves to ensure that allegations of fraud are concrete and particularized enough to give notice to the defendants of what conduct is complained of to

enable the defendants to prepare a defense to such a claim of misconduct. *Rich v. Touche Ross & Co., supra* at 245; *Lewis v. Varnes, supra* at 47; see *Felton v. Walston & Co.*, [508 F.2d 577, 580 (2d Cir. 1974)]."

In this case plaintiffs have submitted a detailed list of the alleged wrongs committed by Stonehenge and other business people, but there has not been a single allegation that the professional defendants made *any representation whatsoever* to plaintiffs, much less a *false representation*; not a single allegation as to the time, place and content of a false representation or the fact misrepresented; not a single allegation as to any reliance by plaintiffs on any representation by the professional defendants; not a single allegation as to any damage caused by any misplaced reliance; and not a single allegation that the professional defendants were connected with plaintiffs' purchases of limited partnership interests. Instead of facts, plaintiffs' complaint contains repetitive allegations that all of the defendants "knew or should have known" various alleged facts and that all of the defendants "aided or abetted" each other.

Courts have repeatedly condemned such pleadings for their failure to comply with Rule 9(b). See, e.g., *Halcyon Securities v. Chase Manhattan Bank*, CCH Fed. Sec. L. Rep. (1977-78 Transfer Binder), ¶96,212 at p. 92,460-61 (S.D.N.Y. 1977); *Plum Tree, Inc. v. N.K. Winston Corp.*, 351 F. Supp. 80, 85 (S.D.N.Y. 1972); and *Fershtman v. Schectman*, CCH Fed. Sec. Law Rep. (1970-71 Transfer Binder), ¶92,996, p. 90,677 (S.D.N.Y. 1971), *aff'd on other grounds*, 450 F.2d 1357 (2d Cir. 1971), *cert. denied*, 405 U.S. 2066 (1972). In *Fershtman*, at p. 90,678, the court dismissed a complaint against accountants brought by buyers of limited partnership interests who, like petitioners herein,

claimed violations of §§ 12(2) and 17(a) of the Securities Act and ¶ 10 of the Exchange Act upon the basis of allegations that the accountants "aided and abetted the Managing Partners in their misrepresentations, fraud, deceit and conspiracy. . . ." The court specifically held that the "aided and abetted * * * conspiracy" language was no substitute for the specific factual allegations required by Rule 9(b). *Id.*

Plaintiffs' close tracking of statutory language does nothing to save their complaint from its fatal defects under Rule 9(b). Indeed, the instant claims, similar to those in *Segal v. Gordon, supra*, "are obviously founded more on an examination of Rule 10b-5 than on an investigation of the facts of the alleged fraud." 467 F.2d at 608. As the *Segal* court stated:

"A complaint cannot escape the charge that it is entirely conclusory in nature merely by quoting such words from the statutes as 'artifices, schemes, and devices to defraud' and 'scheme and conspiracy.'" 467 F.2d at 608.

As plaintiffs admit in paragraph 9 of the complaint, they received one offering brochure as early as November 15, 1972 and the last by January 1, 1974. Plaintiffs have had more than four years to study the offering brochures; two years to investigate since they learned of the alleged fraud in 1975, and well over a year since the original complaint was filed. Until July 1, 1977, when their third complaint (the second amended complaint) was dismissed, plaintiffs had not alleged a single specific fact connecting the professional defendants to the preparation, review, circulation or content of the offering brochures. Instead, and at most, we have the general accusations that *all* of the professional defendants prepared the brochures (¶ 41); that

the alleged fraud could not have been perpetrated without the services and cooperation of the professional defendants (¶ 14); that all of the professional defendants "shut their eyes" to "suspicious circumstances" and thereby aided and abetted (¶ 15) and that if "one or more of the defendants dis [sic] not directly or indirectly commit or were not responsible for one or more of the acts or omissions hereinabove alleged, they aided and abetted the same." (¶ 39)

Plaintiffs' broad brush attempt to smear all of the professional defendants with a general allegation, that all of them prepared unspecified portions of all of the brochures, is patently improper.

In *Lincoln National Bank v. Lampe*, 414 F. Supp. 1270, 1278-9 (N.D. Ill. 1976), the court rejected the very same tactic, stating that the complaint *must* inform each defendant of the specific fraudulent acts which constitute the basis of the plaintiffs' claim against each defendant. It cannot lump alleged misrepresentations in an effort to imply that each defendant is responsible for statements made by the others.

As a matter of law, a complaint should not be filed to seek out possible fraud by a particular party. *Segal v. Gordon, supra*, at 607-08. The practice of filing a complaint lacking in particularity and then seeking discovery to establish a wrong has been soundly condemned. *Segal v. Gordon, supra*; *Rich v. New York Stock Exchange*, 522 F.2d 153, 158 (2d Cir. 1975); *Segan v. Dreyfus Corp.*, 513 F.2d 695, 696 (2d Cir. 1975). As observed in the *Dreyfus* decision:

"When the complaint alleges fraud, Rule 9(b) requires that somewhat more of counsel's investigative efforts be revealed so that the number of unfounded 'strike suits' is minimized and defendants are protected 'from the harm that comes to their reputations or to their

goodwill when they are charged with serious wrongdoing.' " [Citation omitted]. *Id.*

The complaint herein sets forth no specific facts from which it could be reasonably concluded that there is a connection between any of the professional defendants and the alleged wrongful conduct. On the contrary, the complaint serves as a model of a "strike suit" pleading, replete with general accusations. The continuing professional embarrassment to these defendants is manifest and properly was not permitted on the basis of a complaint that so clearly failed to meet the requirements of Fed. R. Civ. P. 9(b).

Examination of the claims against respondents Leslie A. Barth and Bergman & Barth, P.C. (the "Barth firm") shows that they are based upon the theory, stated in the complaint (§ 14), that the alleged fraud in the sale of limited partnership interests "could not be perpetrated without the services and cooperation of professionals such as the defendant accountants and lawyers." * Of course, it is apparent that plaintiffs cannot and do not allege that the Barth firm either offered or sold securities to plaintiffs or anyone else. Plaintiffs cannot and do not allege that the Barth firm participated in the solicitation of plaintiffs or rendered any encouragement or assistance to such solicitation. Plaintiffs cannot and do not allege that the Barth firm was aware of the sales to plaintiffs or that it had actual knowledge of the specific fraud that was allegedly perpetrated upon plaintiffs or that it acted in concert with

* The counts alleged against the Barth firm are the First Count (which is alleged against all defendants and is based upon alleged violations of the federal securities laws), the Fourth Count (the only count directed solely at the Barth firm) and the Seventh, Eighth and Ninth Counts (which are alleged against all defendants).

others to perpetrate the fraud. In other words, plaintiffs are unable to allege any specific facts from which it could be concluded that there was any connection between the fraud allegedly perpetrated by Stonehenge, its officers and directors and Garfinkle on the one hand and the professional services rendered by the Barth firm on the other hand.

Since plaintiffs cannot connect the Barth firm with the alleged fraud by any specific factual allegations, they seek to sustain their second amended complaint on the basis of the allegation that "defendant accountants and lawyers shut their eyes" to suspicious circumstances and "thereby aided and abetted the deceptive concealment worked on Crane and the other investors." (§ 15). However, plaintiffs set forth no factual basis for these allegations. The complaint, again, is completely deficient in that it fails to show that the Barth firm knew of the alleged fraud or knowingly and intentionally assisted or participated in it. The complaint fails utterly to specify the respects in which the Barth firm is alleged to have aided and abetted and was, therefore, properly dismissed. *Segal v. Gordon, supra*; *Rich v. Touche Ross & Co., supra*; *Lincoln National Bank v. Lampe, supra*.

Indeed, the only specific criticism of the Barth firm to be found in the entire complaint is directed to its tax opinion in connection with Clementon. (70a-77a, 93a-94a). Examination of the tax opinion (93a-94a) shows that it is of a kind commonly given in connection with the syndication of limited partnership interests in real estate investments. What is significant here is that *there are no allegations demonstrating any connection between the standard tax opinion letter of the Barth firm and the fraud perpetrated by those alleged in the complaint to be the wrongdoers, i.e.,*

Stonehenge, its officers, directors and Garfinkle. The Barth firm was only consulted in a professional advisory capacity, and on an extremely limited basis, as tax counsel in connection with Clementon. The Barth firm had no meaningful involvement with the underlying real estate transactions or the sale of limited partnership interests.

In discussing the Barth firm's tax opinion letter, the District Court stated (116a-117a):

"This tax opinion letter is specifically identified and attached to the complaint as an exhibit. However, plaintiffs have failed to allege specifically how this tax opinion letter is false or misleading. It appears that plaintiffs have brought this action on the theory that since defendants prepared a standard tax opinion letter, they must have known of all the wrongdoing allegedly perpetrated in this case. A reading of the tax opinion letter makes it clear that none of the alleged wrongdoing had to be known by movants in order to make the tax opinion letter complete for its intended purpose."

We respectfully submit that the foregoing analysis of the United States District Court for the Southern District of New York, adopted by the United States Court of Appeals for the Second Circuit, is correct.

II.

There is No Conflict Between the Decision of the United States Court of Appeals for the Second Circuit and the Decision of Any Other Court of Appeals and There is No Other Ground for Granting A Writ of Certiorari.

Petitioners' chief contention in support of their petition is that "The writ should be granted because there is a conflict between the decision of the court below in the instant case and the decisions of courts of appeal and district courts in other circuits." (17) As we shall show, contrary to petitioners' contention, there is no conflict between the decision of the court below and the decision of any other court of appeals. The alleged conflict between the decision of the court below and district courts in other circuits is not only non-existent but would, in any event, not be a basis for granting a writ of certiorari.

The only court of appeals cases cited by petitioners are *Tomera v. Galt*, 511 F.2d 504 (7th Cir. 1975) and *Dudley v. Southeastern Factor & Finance Corp.*, 446 F.2d 303 (5th Cir. 1971), *cert. denied*, 404 U.S. 858 (1971). Neither is in conflict with the decision of the court below. In *Tomera*, the complaint alleged that it was represented to plaintiff that the three corporate defendants formed to promote a Mexican mining venture "held valid mine leases in Mexico, were carrying on silver mining operations and processing the ore, and planned to use the funds [plaintiff] invested to further develop the mine property and facilities. In fact none of this vital information was true." 511 F.2d at 508. It appears from the court's decision that all of the individual defendants were officers, directors and promoters of the corporate defendants. In addition, some of

the individual defendants had entered into a written joint venture agreement in connection with the promotion of the mining venture which was attached to the complaint. From this description, it is apparent that the complaint in *Tomera* specifically alleged that the individual defendants were the primary perpetrators of a fraud. In contrast, the complaint dismissed by the courts below makes no claim that the professional defendants perpetrated a fraud and, moreover, fails utterly to connect them with the alleged fraud. Thus *Tomera* is completely distinguishable from the instant case: there is no conflict between the decision therein and the decision of the court below in their interpretation of Fed. R. Civ. P. 9(b).

In *Dudley v. Southeastern Factor and Finance Corp.*, 446 F.2d 303 (5th Cir. 1971), *cert. denied*, 404 U.S. 858 (1971), which petitioners cite but do not discuss, the receiver of a corporation claimed that it had been defrauded in violation of Rule 10b-5. Defendants were a finance corporation which had allegedly accomplished the fraud by means of a fraudulent dissolution and liquidation, "its principals, its shareholders as a class, and other corporations." 446 F.2d at 304. Thus, it is apparent that the defendants in *Dudley*, like the defendants in *Tomera*, *supra*, were the principal perpetrators of the fraud alleged in the complaint. Accordingly, *Dudley* is also easily distinguishable from this case. Thus there is no conflict between the decision therein and the decision of the court below.

While the foregoing description of *Dudley*, *supra*, shows that it is inapposite, it is also pertinent to note that the principal question before the court was whether or not plaintiff had standing to sue as a defrauded "seller" within the meaning of Rule 10b-5. The only reference to Fed. R. Civ. P. 9(b) was contained in footnote 6 on page 308 of the court's decision and that reference does not furnish any

support for the assertion that the court in *Dudley*, *supra*, interpreted Rule 9(b) differently than the court below.

The remaining cases cited by petitioners for the proposition that there is a conflict of decision are all district court cases: *Fox v. Prudent Resources Trust*, 382 F. Supp. 81 (E.D. Pa. 1974); *Burkhart v. Allson Realty Trust*, 363 F. Supp. 1286 (N.D. Ill. 1973); *Collins v. Rukin*, 342 F. Supp. 1282 (D. Mass. 1972); and *Cash v. Frederick & Company, Inc.*, 57 F.R.D. 71 (E.D. Wis. 1972). (18) It is well established that this Court

"will not grant certiorari to review a decision of a federal court of appeals merely because it is in direct conflict on a point of federal law with a decision rendered by a district court, whether in the same circuit or in another circuit. The Court tries only to achieve uniformity in federal matters among the various courts whose decisions are otherwise final in the absence of Supreme Court review—[such as] the courts of appeals. . . . It is the duty of the courts of appeals to maintain uniformity within their respective circuits and to supervise the decisions of the various district courts." Stern and Gressman, *Supreme Court Practice*, (4th Ed. 1969), Sec. 4.8.

Moreover, each of the district court cases is distinguishable on the same basis as *Tomera v. Galt*, *supra*, and *Dudley v. Southeastern Factor and Finance Corp.*, *supra*, as involving the application of Fed. R. Civ. P. 9(b) to allegations against insiders and primary fraud doers rather than persons in the position of the professional defendants.

We believe that the recent decision of the United States Court of Appeals for the Second Circuit in *Denny v. Barber, et al.*, No. 76-2946, slip op. at 3077 (2d Cir. May 17, 1978) is

directly on point. In that case, the court affirmed the dismissal of a complaint alleging violations of Rule 10b-5 on the ground, *inter alia*, that it failed to meet the requirements of Fed. R. Civ. P. 9(b). Speaking for the court, Judge Friendly stated:

"Plaintiff's counsel has called our attention to a number of district court decisions, notably *duPont v. Wyly*, 61 F.R.D. 615 (D. Del. 1973), and *Denny v. Carey*, 72 F.R.D. 574 (E.D. Pa. 1976), in the latter of which he was counsel for the same plaintiff as here, which are alleged to have sustained complaints no more specific than this. Defendants dispute this and counter with an equal number of district court decisions alleged to have dismissed complaints more specific than this one. We see no profit in attempting to analyze these decisions, which may or may not be consistent and each of which necessarily rests on its particular facts. We follow the rule laid down by our own decisions, notably *Shemtob v. Shearson, Hammill & Co.*, 448 F.2d 442, 444 (2 Cir. 1974); *Segal v. Gordon*, 467 F.2d 602, 607 (2d Cir. 1972), *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 378-80 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1965), and *Felton v. Walston and Co.*, 508 F.2d 577 (2 Cir. 1974)."

In other words, each decision under Fed. R. Civ. P. 9(b) by its very nature—to use the words of Judge Friendly—"necessarily rests on its particular facts." Thus this case turns solely upon the district court's analysis of the particular allegations contained in the second amended complaint. For this reason too, certiorari should be denied. *United States v. Johnston*, 268 U.S. 220, 227 (1925).

The only other cases cited by petitioners are easily distinguishable and inapposite to the proposition that the

professional defendants had a duty to disclose in this case. (23-24) See *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973).

Thus *Black & Co. Inc. v. Nova-Tech, Inc.*, 333 F. Supp. 468 (D. Ore. 1971), involved a determination, for jurisdictional purposes only, that attorneys who had prepared the legal papers necessary for a corporation to sell securities within Oregon were "participants" in a transaction so as to permit them to be served with process in California. The court specifically held that the issue before it was the attorneys' "participation" and not "the issue of liability". *Id.* at 472.

In *Lewis v. Walston & Co. Inc.*, 487 F.2d 617 (5th Cir. 1973), buyers of unregistered securities brought an action for their losses against a brokerage firm and a registered representative. They alleged violations of §§ 12(1) and 12(2) of the Securities Act of 1933 and the Florida Blue Sky Law. Following a jury verdict against both defendants, the district court granted judgment n.o.v. in favor of the brokerage firm. The buyers and the registered representative appealed. The court of appeals affirmed the judgment against the registered representative, reversed the judgment in favor of the brokerage firm and remanded the case for entry of judgment against the brokerage firm. It is difficult to understand how this case has any bearing on whether the professional defendants had a duty to disclose in the instant case.

U. S. v. Natelli, 527 F.2d 311 (2d Cir. 1975) involved criminal charges against an accountant who knowingly issued false and misleading financial statements. *U. S. v. Benjamin*, 328 F.2d 854 (2d Cir.) *cert. denied sub nom. Howard v. United States*, 377 U.S. 953 (1964), involved an attorney who prepared and delivered misleading opinion letters concerning the shares that were sold.

None of these cases has any bearing upon the issue before this Court, that is, whether or not certiorari should be granted. Indeed, they serve only to emphasize that this case has no importance beyond the particular facts and parties involved. It is impossible to discern in the petition before this Court any question of significance in terms of interpretation of any federal statute or the administration of the federal courts. The petition fails completely to set forth any considerations of the character enumerated in Rule 19 of this Court which traditionally have influenced the Court to grant certiorari.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Dated: New York, New York
June 16, 1978

Respectfully submitted,

ROBERT E. SMITH
80 Pine Street
New York, New York 10005
Attorney for Respondents
Bergman and Barth, P.C. and
Leslie A. Barth

Of Counsel:

GUGGENHEIMER & UNTERMYER
80 Pine Street
New York, New York 10005

JUL 12 1978

MICHAEL BODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1977

No. 77-1638

JAMES E. CRANE; JAMES E. CRANE, M.D., P.C.; and JAMES E. CRANE and MARY ELLEN CRANE, Trustees of James E. Crane, M.D., P.C. Pension Trust (on behalf of themselves and investors similarly situated),

Petitioners,

v.

LESLIE A. BARTH; BERGMAN AND BARTH, P.C.; PIERSON, DUEL & HOLLAND; and RITCH, GREENBERG & HASSAN,

Respondents.

**BRIEF OF RESPONDENT
PIERSON, DUEL & HOLLAND
IN OPPOSITION TO PETITION FOR
A WRIT OF CERTIORARI**

LEONARD S. BAUM
*Attorney for Respondent
Pierson, Duel & Holland*
40 West 57th Street
New York, New York 10019
(212) 977-9700

Of Counsel:

PHILLIPS, NIZER, BENJAMIN,
KRIM & BALLON
New York, New York

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IN THE
Supreme Court of the United States
October Term, 1977

No. 77-1638

JAMES E. CRANE; JAMES E. CRANE, M.D., P.C.; and JAMES
E. CRANE and MARY ELLEN CRANE, Trustees of James E.
Crane, M.D., P.C. Pension Trust (on behalf of themselves
and investors similarly situated),

Petitioners,

v.

LESLIE A. BARTH; BERGMAN AND BARTH, P.C.; PIERSON,
DUEL & HOLLAND; and RITCH, GREENBERG & HASSAN,

Respondents.

**BRIEF OF RESPONDENT
PIERSON, DUEL & HOLLAND
IN OPPOSITION TO PETITION FOR
A WRIT OF CERTIORARI**

Question Presented

Whether this Court should grant certiorari to review
the unanimous decision of the Court of Appeals affirming
the District Court's dismissal of petitioners' second amend-
ed complaint, with prejudice, which alleged fraud violations

of the securities laws by the respondent law firm, on the grounds that (a) the complaint failed to allege fraud with the particularity required by Fed. R. Civ. P. 9(b), and (b) the complaint failed to state a claim against the respondent law firm because it did not allege any relationship between respondent and the preparation of the allegedly misleading offering brochures so as to create a duty of disclosure.

Statement of the Case

1. Nature of This Case and the Parties

This lawsuit arose out of the financial collapse of Stonehenge Industries, Inc. ("Stonehenge"). Stonehenge acquired various parcels of income-producing real estate, transferred those parcels to limited partnerships, and then sold interests in the limited partnerships to investors as real estate tax shelters. Petitioners purchased interests in three different partnerships. When their investments failed, petitioners sued under the federal securities laws, claiming fraud and deception by Stonehenge, its officers and directors, the person who sold certain real estate to Stonehenge, the sales representative of Stonehenge, and every lawyer and accountant who rendered any professional services to Stonehenge. Included was respondent Pierson, Duel & Holland, a small law firm in Greenwich, Connecticut, which rendered real estate services to Stonehenge.

This lawsuit has not progressed beyond the pleading stage. Respondent and the other professional defendants have successfully moved to dismiss the original and amended complaints on the grounds that (a) the complaints did

not contain specific averments of fraud as required by Fed. R. Civ. P. 9(b), and (b) the complaints failed to state a cause of action under the securities laws. The dismissals were unanimously affirmed by the Court of Appeals for the Second Circuit, which also denied petitioners' motion for a rehearing. These proceedings are discussed below in detail. Essentially, petitioners' request for certiorari seeks yet another exhaustive factual analysis of their complaint in the hope that this Court will find it sufficient.

2. The Proceedings Below

The original complaint filed on November 26, 1975 alleged violations of §17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §77q(a), §§10(b), 15(c) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78j(b), §78o(c) and §78t(a), respectively, and S.E.C. Rules 10-b, 10b-5 and 15c 1-2. Since Pierson, Duel & Holland had nothing whatsoever to do with the preparation and distribution of any brochures and circulars or with Stonehenge's sale of limited partnership interests, and since the complaint set forth no facts to the contrary, respondent moved to dismiss the complaint on the grounds identified above. Respondent also moved for summary judgment based on affidavits in which Pierson, Duel & Holland unequivocally stated that it played no part whatsoever in the sale of limited partnership interests to petitioners or anyone else; that it never prepared any offering circular or other sales document; never issued any opinion or made any statement contained in any offering circular or sales document; never authorized the identification of the law firm in any offering circular as an expert in any field or as having passed upon any matter contained in the

offering circular, and never had any involvement with the securities aspects of any offer or sale of limited partnership interests by Stonehenge.*

Petitioners' original complaint was dismissed with leave to replead. An amended complaint was filed on June 14, 1976 but it was as deficient as the original and respondent again moved to dismiss and for summary judgment. On September 7, 1976 the District Court dismissed the amended complaint as to Pierson, Duel & Holland, stating that it "fails utterly to set forth a specific fact from which it could be concluded that there is a connection between the defendant law firm and the alleged wrongful conduct" and that it lacked the specificity mandated by Rule 9(b).

Petitioners were permitted to file a second amended complaint, which they did, and again respondent moved to dismiss and for summary judgment.** The District Court dismissed the complaint, with prejudice, noting that it was the "third time that the court has been presented with a motion to dismiss" for petitioners' failure to comply with Fed. R. Civ. P. 9(b), and that although the third complaint was "facially rearranged," it contained no greater specificity than before" (108a).† The court carefully reviewed

* The lower courts never ruled on respondent's motion for summary judgment since, in each instance, the complaint was found to be legally insufficient.

** The second amended complaint added an alleged violation of §12(2)q of the Securities Act, 15 U.S.C. §771(2) and dropped certain earlier allegations. The remaining Federal claims are under §10(b) of the Exchange Act and §§12(2) and 17(a) of the Securities Act.

† Numerical references followed by the letter "a" are to pages in the Appendix.

the allegations in the complaint and concluded that it did not satisfy Rule 9(b) for the following reasons:

"It is apparent from a reading of this complaint that the heart of this alleged fraud was the preparation and distribution of various brochures and circulars and material omissions in them. Plaintiffs have failed to allege any set of facts that tie this defendant to the preparation of those brochures. The bald assertion contained on paragraph 41 that '[t]hose brochures were prepared by defendants Leslie A. Barth; Bergman and Barth; Pierson, Duel & Holland; Ritch, Greenberg & Hassan; and Donald Lawrence' is not sufficient. It gives no notice to this defendant as to what specifically it is alleged to have done wrong. It is exactly this type of joint accusation which forced the court in *Lincoln National Bank v. Lampe*, 414 F. Supp. 1270, 1278 (N.D. Ill. 1976), to dismiss the complaint in that case." (110-111a)

"There is no indication as to which of the various brochures and circulars contained these false statements, what the statements were, why they were false, or who were responsible for them. These are not statements of fact, merely conclusions and therefore insufficient to satisfy Rule 9. *Shemtob v. Shearson, Hammill & Co.*, 448 F.2d 442 (2d Cir. 1971)." (110a)

The court also concluded that the complaint failed to state a cause of action for the following reason:

"Furthermore, even assuming that this defendant had knowledge of various facts that plaintiffs have alleged to have been omitted from the brochures, as enumerated in paragraph 37, the complaint fails to state a claim against this defendant. '[M]ere possession and non-disclosure of material facts does not alone create liability under Rule 10b-5; there must be, in addition, some relationship which generates a duty to inform.' *Gold v. DCL, Inc.*, 399 F. Supp. 1123, 1127

(S.D.N.Y. 1973). Plaintiffs have failed to establish any relationship between this defendant and the preparation of the questionable brochures, and thus there can be no liability for failure to disclose." (111-112a)

Thereafter, the Court of Appeals unanimously affirmed the final dismissal on the opinion of the District Court, and unanimously denied a petition for rehearing (118-122a).

Reasons for Not Granting Certiorari

Petitioners have filed three lengthy complaints listing a litany of supposed acts, misrepresentations and omissions of Stonehenge, its officers, and a seller of properties with whom they dealt. None of the acts, misrepresentations or omissions was attributed to this respondent. Petitioners claim that respondent should be liable because it "knew or should have known" or "willfully and recklessly disregarded" the situation; because it did nothing and said nothing.

Every one of petitioners' complaints was exhaustively analyzed by the District Court. The final complaint was analyzed twice by the Court of Appeals. The decisions of those courts were emphatic and unanimous in finding the complaint to be insufficient. There is no reason whatsoever for this Court to conduct another exhaustive factual analysis. The decisions below were correct, and there is no basis for seeking certiorari.

There is no conflict among the decisions of the circuit courts of appeal, and no conflict between those decisions and learned authority concerning the purpose, interpretation and implementation of Rule 9(b). Similarly, there is

no conflict among authorities on the legal test for whether a complaint has stated a cause of action. All of the circuit courts which have addressed the issue have endorsed the basic legal principle that before a person will be held liable for non-disclosure under the securities laws, there must first exist a relationship which imposes a duty to disclose.

Each case of this type will turn on its own peculiar facts. The District Court and Court of Appeals have reviewed the facts at bar, have considered petitioners' exposition of their claims both orally and in briefs, and have concluded that even if all of petitioners' allegations were true, they are procedurally and substantively insufficient. Another review of this judgment would not produce a contrary result, nor could it give guidance to the bench or bar in other cases.

The true question posed by the petition is whether the Supreme Court should review every complaint dismissed for legal insufficiency to determine whether the Supreme Court's factual analysis is consistent with that of the District Court and the Court of Appeals. A grant of certiorari in this case simply would convert the Supreme Court into the third stage of a three-tier procedure under which every litigant could seek three successive reviews of his complaint, no matter how defective its form or content. It would reward, rather than discourage, the filing of complaints based on insufficient legal and factual research. It would enable hip-shooting litigants to coerce cost-of-litigation settlements at the expense not only of the defendants, but of the federal courts which will be burdened with endless reviews of claims which cannot pass muster.

ARGUMENT

I

There Is No Conflict Concerning the Purpose, Interpretation and Implementation of Fed. R. Civ. P. 9(b).

Fed. R. Civ. P. 9(b) states in relevant part:

“In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.”

This rule repeatedly has been enforced in securities lawsuits against attorneys and accountants. Also, courts repeatedly have stressed the three distinct purposes for Rule 9(b)'s specificity requirement:

1. To inhibit the filing of a complaint as a pretext for discovering unknown wrongs. A complaint alleging fraud should serve to redress a wrong, not to find one.

2. To protect potential defendants from the harm which comes to their reputations when they are charged with the commission of acts involving moral turpitude, especially where the potential defendants are professionals, whose reputations in their field of expertise are most sensitive to slander.

3. To ensure that allegations of fraud are sufficiently concrete and particular enough to give notice to the defendants of the conduct complained of so as to enable the defendants to prepare a defense.

Rich v. New York Stock Exchange, 522 F.2d 153, 158 (2d Cir. 1975); *Segan v. Dreyfus Corp.*, 513 F.2d 695, 696 (2d Cir. 1975); *Felton v. Walston and Co., Inc.*, 508 F.2d 577, 581-82 (2d Cir. 1974); *Segal v. Gordon*, 467 F.2d 602, 607-08 (2d Cir. 1972); 5 Wright & Miller, *Federal Practice and Procedure*, Civil §1296.

Petitioners have cited no contrary authority, and refer to only two inapplicable circuit court decisions, which we discuss below, *Tomera v. Galt*, 511 F.2d 504 (7th Cir. 1975) and *Dudley v. Southeastern Factor and Finance Corp.*, 446 F.2d 303 (5th Cir. 1971), *cert. denied*, 404 U.S. 858 (1971).*

In *Tomera*, the complaint alleged purchases of notes and stock in reliance upon false representations that defendants held valid mine leases, were carrying out mining operations, and planned to use the funds invested by the plaintiffs in developing a mine and its operations. Attached to the complaint was a joint venture agreement signed by nearly all defendants which “set out more than enough details of defendants’ common purpose and their control over the defendant corporation.” The Fifth Circuit concluded that the complaint, in its entirety, had specified the fraudulent representations attributable to both the individual and corporate defendants.

The facts of *Dudley* were as follows: “ITCC” was a preferred shareholder of “SEFAF.” SEFAF’s assets principally were comprised of stock holdings in Atlantic Services, Inc. (“Atlantic”). SEFAF adopted a plan to liquidate under which the Atlantic stock was to be distributed to SEFAF’s creditors and shareholders. In the course of the liquidation, nothing was distributed to ITCC. ITCC claimed that the transaction left it with preferred shares in a corporation lacking an operative existence. *Dudley* held that the liquidation constituted, in effect, a forced sale of ITCC’s shares in SEFAF which afforded it standing as a “seller” to sue under the Exchange Act. The sole reference to Rule 9(b) was in footnote 6, on page 308, which stated that where the complaint specifically described

* *Dudley* was cited but not discussed in the petition.

the above transaction, and that Atlantic and SEFAF both were aware of but ignored ITCC's position as a preferred shareholder entitled to participate in the plan of liquidation, these allegations were sufficient under Rule 9(b). There is nothing in *Dudley* inconsistent with the Second Circuit's interpretation of Rule 9(b)—it is just another case-by-case application of the established rule. Similarly, the four district court cases cited in the petition are just additional examples of where courts have made a case-by-case analysis of a particular set of facts.

Furthermore, the two district court cases discussed in the petition were mischaracterized.* In *Fox v. Prudent Resources Trust*, 382 F. Supp. 81 (E.D. Pa. 1974), the complaint specified misstatements in a prospectus upon which the plaintiffs relied. In *Cash v. Frederick & Co., Inc.*, 57 F.R.D. 71 (E.D. Wis. 1972), the plaintiffs identified the applicable NASD Rule and situation in which a stockbroker violated his duty to make a proper investigation prior to recommending the purchase of a specific security where the plaintiff had relied on such advice to his detriment.

Petitioners' citation of these cases underscores the morass which will confront this Court should it grant certiorari in a case such as this. Indeed, the citation to these cases is of questionable value in light of this Court's observation that certiorari is not warranted unless there is a conflict in decisions between circuits. *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175 (1938). See also Stern and Gressman, *Supreme Court Practice* (4th Ed. 1969), Sec. 4.8.

* The two other district court cases cited but not discussed in the petition will not be treated here.

It is apparent that petitioners have wholly failed to identify any conflict among legal authorities and that their petition simply disputes the factual analysis of the complaint by the courts below. In such circumstances a writ of certiorari should not be granted. *United States v. Johnston*, 268 U.S. 220, 227 (1925); *Southern Power Co. v. North Carolina Public Service Co.*, 263 U.S. 508 (1924); *Rogers v. Missouri Pacific R.R. Co.*, 352 U.S. 500, 524 (1957) (Frankfurter, J., dissenting).

Petitioners' final plea, that the effect of the decision below is to exclude small and medium investors from access to the Federal courts (Petition, p. 22), is belied by their ability to have three complaints reviewed time and again by the District Court and Court of Appeals. The question is not of access, but of petitioners' failure to meet a threshold burden of stating a basic claim cognizable under the Federal Rules. Instead of filing one rehashed complaint after another, petitioners should have heeded Judge Weinfeld's admonition in *Miller v. Schweickart*, 413 F. Supp. 1059, 1061 (S.D.N.Y. 1976) that numerous defendants should not be named, in blunderbuss fashion, in a variety of charges based only on a slight relationship with those actively involved in the affairs of a company subject to litigation; that claims should be commenced only against those as to whom plaintiffs could confirm a basis for suit, and that discovery should be employed to determine if additional party defendants are warranted. Petitioners had more than two years to conduct such an investigation in this case. Petitioners repeatedly demonstrated their awareness of depositions conducted by the S.E.C. in actions against the Stonehenge officers allegedly responsible for petitioners' losses.* Given

* Plaintiffs also knew that although the S.E.C. investigated and commenced actions arising out of the Stonehenge collapse, no charges ever were lodged against respondent.

these facts, the necessary conclusion is that petitioners either failed to make the requisite initial investigation or, having done so, failed to uncover any basis for implicating respondent. In either event, petitioners have not been excluded from access to the federal courts. Numerous prior decisions have admonished plaintiffs to investigate the involvement of specific defendants in fraudulent activities and not to file a fraud suit in the absence of specific allegations because the severe damage to the reputation of an attorney who has spent years developing a practice based on integrity, ability and industry may be impossible to undo.

II

There Is No Conflict of Authority on the Need for a Duty to Disclose as a Condition Precedent to Securities Law Liability Arising Out of Inaction or Silence.

The court below concluded that petitioners failed to plead any relationship between the respondent law firm and the preparation of the questionable brochures, and that absent such a relationship there could be no liability for the alleged possession and non-disclosure of material facts (111-112a).

Once again petitioners have shown no conflict of authority on this legal principle. They simply cite two cases, without discussion, for the proposition that a duty of disclosure exists merely where the name of the defendant attorney is used in connection with the sale of securities (Petition, 23). Petitioners' contention and their authorities are in error.

Black & Co. v. Nova-Tech, Inc., 333 F.Supp. 468 (D. Ore. 1971) involved a district court holding that attorneys were subject to the long-arm jurisdiction of Oregon where they prepared legal papers necessary for a corporation to complete its sale of securities and authorized the issuer to use the law firm's name as corporate counsel on its annual reports. *Lewis v. Walston & Co., Inc.*, 487 F.2d 617 (5th Cir. 1973) imposed absolute liability on a broker-seller in the sale of unregistered securities and has no conceivable relationship to the issue at bar. Petitioners' citation to two cases concerning the liability of accountants is equally misleading. The cases are also decisions of the Second Circuit, the very circuit which rendered the decision below. *United States v. Natelli*, 527 F.2d 311 (2d Cir. 1975) involved criminal charges against an accountant who knowingly issued false and misleading financial statements. *United States v. Benjamin*, 328 F.2d 854 (2d Cir. 1964), *cert. denied*, 377 U.S. 953 (1964) imposed liability on an auditor who knowingly issued false and misleading financial statements to promote the sale of unregistered securities.

Petitioners have ignored an unbroken line of circuit court decisions in accord with the legal standard imposed by the Second Circuit. It is crystal clear that before an attorney has a duty to disclose alleged errant conduct of his client, it must first be shown that the attorney uttered some statement, representation or opinion which was misleading and which was relied upon by the plaintiffs. Time and again courts have rejected the extraordinary theory that an attorney will be liable as an aider and abettor for failing to disclose knowledge of a client's activities absent a prior undertaking by the attorney of some obligation to

the purchaser. *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973); *Wessel v. Buhler*, 437 F.2d 279 (9th Cir. 1971); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84 (5th Cir. 1975); *S.E.C. v. Coffey*, 493 F.2d 1304, 1316-17 (6th Cir. 1974); *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 889 (3d Cir. 1975), *cert denied*, 425 U.S. 993 (1976).

Since the legal standard for imposing securities law liability on the basis of silence or inaction is so well established and in accord with the decision below, petitioners' request for certiorari necessarily must rest upon their displeasure with the lower court's factual analysis of their complaint. For the reasons previously discussed, certiorari is not justifiable in such circumstances.

Conclusion

The foregoing analysis demonstrates that petitioners have failed to present this Court with any of the traditional bases for the granting of certiorari. There is no conflict of authority on any legal proposition. There is no important question of law to be resolved. This case does not differ from innumerable situations which require their own particular factual analyses in light of established law. Accordingly, the writ for certiorari should be denied.

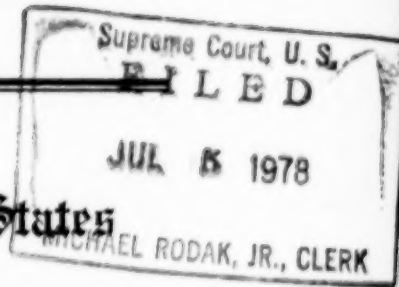
Respectfully submitted,

LEONARD S. BAUM
Attorney for Respondent
Pierson, Ducl & Holland
 40 West 57th Street
 New York, New York 10019

Of Counsel:

PHILLIPS, NIZER, BENJAMIN,
 KRIM & BALLON
 New York, New York

IN THE
Supreme Court of the United States
Docket No. 77-1638



JAMES E. CRANE: JAMES E. CRANE, M.D., P.C.; and JAMES
E. CRANE and MARY ELLEN CRANE, Trustees of JAMES
E. CRANE, M.D., P.C. PENSION TRUST (on behalf of
themselves and investors similarly situated),

Petitioners,

—v.—

LESLIE A. BARTH; BERGMAN AND BARTH, P.C.; PIERSON, DUEL
& HOLLAND: and RITCH, GREENBERG & HASSAN,

Respondents.

**BRIEF OF RESPONDENTS RITCH, GREENBERG &
HASSAN IN OPPOSITION TO PETITION
FOR WRIT OF CERTIORARI**

KENNETH A. SAGAT
ROBERT P. O'NEILL
PAUL A. IMMERMANN
70 Pine Street
New York, New York 10005
Attorneys for Respondents
Ritch, Greenberg & Hassan

Of Counsel:

D'AMATO & LYNCH
70 Pine Street
New York, New York 10005

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IN THE
Supreme Court of the United States
Docket No. 77-1638

JAMES E. CRANE: JAMES E. CRANE, M.D., P.C.; and JAMES E. CRANE and MARY ELLEN CRANE, Trustees of JAMES E. CRANE, M.D., P.C. PENSION TRUST (on behalf of themselves and investors similarly situated),

Petitioners,

—v.—

LESLIE A. BARTH; BERGMAN AND BARTH, P.C.; PIERSON, DUEL & HOLLAND: and RITCH, GREENBERG & HASSAN,

Respondents.

**BRIEF OF RESPONDENTS RITCH, GREENBERG &
HASSAN IN OPPOSITION TO PETITION
FOR WRIT OF CERTIORARI**

Opinions Below

The opinions of the District Court are annexed to the petition as Appendices D, E, & F.

Court of Appeals affirmed the opinions of the District Court and did not render an opinion of its own.

None of the aforesaid opinions have yet been officially reported.

Jurisdiction

The jurisdictional requisites are set forth in the petition at page 2.

Question Presented

Whether a plaintiff must aver the circumstances constituting fraud with particularity in an action alleging securities laws violations.

Statutes Involved

The pertinent Federal Rules of Civil Procedure are FRCP 8(a) and (e), 9(b), and Form 13 appended to the Federal Rules of Civil Procedure.

The pertinent statutory provisions of the Securities Act of 1933 are Section 5, 15 USC Section 77 E; Section 12(2), 15 USC Section 770(2); Section 13, 15 USC Section 77M; Section 17(a), 15 USC Section 77Q(a).

The pertinent statutory provisions of the Securities Exchange Act of 1934 are §10(b), 15 U.S.C. §78J(b); §15(c), 15 U.S.C. §78O(c); §20(a), 15 U.S.C. §78T(a).

The pertinent rules of the Securities Exchange Commission are Rule 10B-5, 17 CFR 240.10(b)-5 and Rule 15CL-2, 17 CFR 240.15CL-2.

Statement of the Case

1. Nature of This Action and the Parties

This action was commenced on November 26, 1975 by the filing of a complaint alleging violations of §17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77q(a), §§ 10(b), 15(c) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), o(c) and t(a), respectively, and S.E.C. Rules

10b, 10b-5 and 15c1-2. The first amended complaint added an alleged violation of Securities Act § 5, 15 U.S.C. § 77e, which was later abandoned. The second amended complaint added an alleged violation of § 12(2) of the Securities Act, 15 U.S.C. § 77l(2).

At this juncture plaintiffs are asserting claims only under § 10(b) of the Exchange Act, and §§ 12(2) and 17(a) of the Securities Act. (App. Br. 2)¹ Plaintiffs also have asserted claims, relying on pendent jurisdiction, for reckless, wanton and/or willful acts and representations by defendants; negligent representations, and breach of fiduciary relationship.

The plaintiffs are Dr. James E. Crane, individually, as a trustee of his pension trust and as a professional corporation, and his wife, Mary Ellen Crane, as trustee of Dr. Crane's pension trust. Plaintiffs seek to recover losses allegedly sustained on their limited partnership investments in three real estate tax shelters. The nature and date of purchase of these interests were as follows:

a) A limited partnership interest in Reading-Easton Associates—purchased on November 15, 1972 for \$26,000 (17a);²

b) A limited partnership interest in Carlene Tower Associates—purchased on June 15, 1973 for \$13,000 (*id.*); and

c) A debenture issued by Clementon Associates purchased on January 1, 1974 for \$7,500. (*id.*)

¹ Citations preceded by "App. Br." indicate references to pages in Appellants' Brief.

² References designated "a" are to the pages of the appendix filed by appellants herein.

The defendants are: the corporation which formed the limited partnerships and sold interests therein to the public—Stonehenge Industries, Inc. ("Stonehenge"); the officers and directors of Stonehenge—Messrs. Constantine, Ward and Henderson; Howard N. Garfinkle, who allegedly sold real estate properties to Stonehenge and improperly obtained and misappropriated funds from Stonehenge; the sales representatives of Stonehenge—Grayson Securities, Inc. and Arthur Grayson; and every lawyer and accountant who rendered any professional services to Stonehenge including Ritch, Greenberg & Hassan ("Hassan") certified public accountants; Donald L. Lawrence, an attorney; Leslie A. Barth and Bergman and Barth, P.C., attorneys, and Pierson, Duel & Holland, attorneys.

2. Prior Motions to Dismiss and Decisions of the Court

Defendants Hassan and Pierson, Duel & Holland moved to dismiss the original complaint on several grounds including plaintiffs' failure to comply with Fed. R. Civ. P. 9(b) and plaintiffs' failure to state a claim upon which relief can be granted. The original complaint was dismissed on May 27, 1976 with leave to replead. An amended complaint was filed on June 14, 1976 but it was as deficient as the original and new motions to dismiss were filed.

On September 7, 1976 the District Court dismissed the amended complaint as to Pierson, Duel & Holland stating that it failed utterly to set forth a specific fact from which it could be concluded that there was any connection between the defendant law firm and the alleged wrongful conduct and that it lacked the specificity mandated by Rule 9(b).

On September 23, 1976 and November 30, 1976 the amended complaint also was dismissed as to Hassan and

Barth and Bergman and Barth, P.C., respectively, on Rule 9(b) grounds.

Thereafter, plaintiffs moved for reconsideration of the dismissals and for leave to file a second amended complaint. Leave was granted and a second amended complaint was filed on December 20, 1976. That complaint proved to be a rehashed version of its predecessors and defendants were compelled to move once again. This time the District Court granted the motions, with prejudice, noting that although "facially rearranged" (108a) the third complaint contained "no greater specificity than before" (108a). The complaints relating to Hassan, Bergman & Barth and Barth similarly were dismissed on Rule 9(b) grounds.

Since all of these dismissals were based solely on an analysis of the complaint, we respectfully refer to that document alone—not the expanded interpretation found in Appellants' Brief—as the touchstone for this Court's review.³

The U.S. Court of Appeals for the Second Circuit affirmed the decision of the District Court without opinion.

Reasons for Denying the Writ as to Defendants Ritch, Greenberg & Hassan

Notwithstanding Plaintiffs' assertion, the decision of the Court below is not in conflict with the decisions of the Courts of Appeal and District Courts in other circuits. The Courts below have consistently applied the require-

³ The Second Amended Complaint appears at pages 12a-62a of the Appendix. The discussion *infra* cites two specific paragraphs of the Complaint itself.

ments of FRCP 9(b) to actions alleging securities violations. See, e.g., *Segal v. Gordon*, 467 F. 2d 602 (2d Cir. 1972). The circuits have been consistent in their uniform application of rule 9(b) FRCP. The following representative decisions are in accord with the decision rendered in the instant case: *Wessel v. Buhler*, 437 F. 2d 279 (9th Cir. 1971); *Dayco Corp. v. Goodyear Tire and Rubber Company*, 523 F. 2d 389 (6th Cir., 1975); *Schaefer v. First National Bank*, 509 F. 2d 1287 (7th Cir. 1975) *cert. denied* 96 S. Ct. 1682; *Walling v. Beverly Enterprises*, 476 F. 2d 393 (9th Cir., 1973); *Seligson v. Plum Tree, Inc.*, 361 F. Supp. 748 (D.C. Pa., 1973) *reh. den.* 61 FRD 343; *Academic Travel Abroad, Inc. v. Kupper*, 54 FRD 576 (D.C. Wis. 1972). In applying FRCP 9(b), the Courts below do not require evidentiary matter to be set forth in the complaint, but rather require averments setting forth the circumstances of the alleged fraud with particularity. *Segal v. Gordon*, *supra*. This is merely a rational implementation of congressional intent as set forth in FRCP 9(b).

The very first sentence of the complaint in the instant case, signals its insufficiency through the statement that each and every allegation is upon information and belief except paragraphs 1-10. (2a) The complaint is not accompanied by any statement of the facts upon which the belief is founded.⁴

In the first ten paragraphs of the complaint, the only allegations made with knowledge, refer to jurisdiction (§ 1); claimed violations of §§ 12 and 17(a) of the Securities Act, and § 10 of the Exchange Act (§ 2), as well as

⁴ For this reason alone, as discussed below, the complaint should be dismissed.

other claimed violations of the securities laws, in the sale of limited partnership interests through Stonehenge, which alleged violations are not in issue on this appeal; venue (§ 3); the appropriateness of class action certification under Fed. R. Civ. P. 23 (§ 4); the applicability of the factual allegations to all plaintiffs (§ 5); the composition and common interests of the class (§ 6); the identity of the plaintiffs and the limited partnerships in issue (§ 7); assertions by plaintiffs of their commencement of the action as a class action (§ 8); identification of the specific purchases by Crane, and the dates and amounts of those purchases (§ 9), and allegations that sales and solicitations were made by use of the mails (§ 10).

All of the remaining allegations, as summarized below, are pleaded on information and belief.

The complaint alleges that Stonehenge organized limited partnerships as real estate syndications which were offered and sold to the public; that Stonehenge, Constantine and Ward were general partners and that Constantine, Ward and Henderson were officers and directors of Stonehenge (§ 11 (a)); that Garfinkle sold the properties acquired by the limited partnerships, became the "wrap around mortgagee" and was able to misappropriate mortgage payments; that he conspired with Stonehenge, Constantine, Ward and Henderson, and that he "was aided and abetted by the other defendants herein" (§ 11(b)). There follows a description of defendants Grayson Securities and Grayson (§ 11(c)) and Donald Lawrence, Esq. (§ 11(b)).

The complaint then describes the purpose of the three limited partnerships—to acquire and operate real estate (§ 11a)—and claims that the organization, operation and sale of the limited partnerships were steeped in fraud

and deception and that the fraud led to an S.E.C. injunction against such practices (§ 12). The complaint *carefully omits* the uncontested fact that the S.E.C. never took action against or enjoined any of the professional defendants.

Paragraphs 14 and 15 constitute the nub of plaintiffs' complaint. They restate the theme found in the amended and original complaints and in Appellants' Brief.⁵ Both paragraphs reveal that the claim against appellees is based on supposition, surmise and speculation—not fact. Plaintiffs claim, in *res ipsa loquitur* fashion, that the fraud in the sale of the limited partnerships “could not be perpetrated without the services and cooperation of professionals such as defendant accountants and lawyers” (§ 14); that “[a]t the very least, there were highly suspicious circumstances [that] should have been investigated” (§ 15); and that the “defendant accountants and lawyers shut their eyes to those circumstances, and made no inquiry into them, and made no disclosure, and thereby aided and abetted the deceptive concealment worked on Crane and the other investors.” *Id.*

The manner in which the fraud occurred is set forth following allegations that relevant information was concealed from plaintiffs (§ 16); that limited partnership interests were offered to numerous investors in various states; that substantial monies were realized on such sales (§§ 17, 18), and that the S.E.C. had asserted a requirement for registration prior to such sales (§ 19).

The complaint then lists a litany of supposed facts and events which all of the defendants “knew or should have known” or “willfully and recklessly disregarded,” and as

⁵ (App. Br. 6).

to which there was no disclosure. *It is noteworthy that all of these allegations involved acts, misrepresentations and omissions of Stonehenge, its officers and Garfinkle. None involved any of the professional defendants.*

The allegations are that appellees should have known of the requirements asserted by the S.E.C. (§ 20); that the sale of the limited partnership interests constituted unlawful sales of securities (§ 21); that the properties acquired by Stonehenge from Garfinkle involved collusion and the absence of arm's length negotiations (§ 22); that Garfinkle had a criminal record (§ 23); that although the securities were offered as “tax shelter investments” in honestly managed entities, the real properties were acquired, sold and managed for the benefit of Garfinkle, Stonehenge and its officers (§ 24); that Garfinkle obtained properties for little or no cash, or by placing junior mortgages against the properties (§ 25); that Stonehenge paid Garfinkle substantially more for the properties than he had paid (§ 26); that Stonehenge assumed various mortgages with the effect that the properties produced insufficient cash flow for debt service (*id.*); that by using a “wrap around mortgage” granted to Garfinkle, he controlled the manner in which junior mortgages were paid (§ 27); that no escrow fund was set up (§ 28); that Stonehenge exercised no control over the properties, and that Garfinkle misappropriated funds earmarked for the payment of mortgages (*id.*); that Garfinkle controlled the management and operation of the properties through certain agreements and arrangements (§ 29); that Stonehenge prepaid certain interest payments to Garfinkle which he did not use to pay junior mortgages (§ 30); that the properties purchased by plaintiffs were being foreclosed or had been foreclosed, and that the plaintiffs had suffered serious

financial losses (§ 31); that the properties were poorly managed (§ 32); that the limited partnerships were poorly managed and their funds wasted (§§ 33, 34); that Stonehenge and its officers accepted information from Garfinkle on the properties without independent verification which information Stonehenge in turn relied on and used for the purpose of soliciting investors (§ 35); and that Stonehenge issued literature that referred to non-existent financing possibilities (§ 36). Once again we pause to emphasize that all of these charges, whether or not they are true, have absolutely no relationship to any acts taken by the professional defendants.

Paragraph 37 of the complaint makes plain that the professional defendants played no part in the solicitation or sales of securities, and that they never distributed any offering brochures; that was done by Stonehenge, its officers and its sales representatives. Plaintiffs merely state, generally that the efforts of Stonehenge were "aided and abetted" by "defendants Barth, Bergmen and Barth, Pierson Duel & Helland and Ritch, Greenberg & Hassan." (§ 37)

Although paragraph 37 lists all of the ways in which the sales efforts and circulars were alleged to be false and misleading *there is not the slightest specification of how the professional defendants are claimed to have aided and abetted*. The most that plaintiffs ever said is that the professional defendants shut their eyes to those circumstances, made no inquiry and made no disclosure (§ 15), and the general allegations in paragraph 41 that *all* of the professional defendants prepared *all* of the offering brochures for *all* of the investments in Reading Easton, Carlene and Clementon.

Plaintiffs sought to detail their purported claims against Hassan in the second count of the complaint (§§ 42-67). These allegations also parrot the previously discussed conclusory allegations of paragraphs 7 through 41.

This claim begins with the allegation that a partner in the Hassan firm acted within the scope of his authority and that the Hassan firm rendered a variety of accounting services for Stonehenge (§§ 43-44).

Plaintiffs then allege that Hassan performed accounting services for Stonehenge (§ 45) and that "as the accountants should have inquired into and disclosed . . . the misleading omissions and statements alleged in pars. 11 through 41" (*Id.*);" plaintiffs further alleged that Hassan knew or had reasonable grounds to suspect the blatant deceptions being worked by Stonehenge, et al., including the circumstances through which the partnerships obtained their properties, the arrangements made with respect to the properties, how those partnerships were being operated, what was happening to the funds that came from investors and that Hassan "consciously cooperated in keeping those facts concealed." (§ 46)

The complaint further alleges that Hassan prepared financial statements for Stonehenge for at least the years 1971 through 1974 (§ 47) and that brochures were distributed to the public, including Plaintiffs, to induce them to invest (§ 48).

It should be noted that plaintiffs nowhere allege that Hassan issued *certified statements* or that Hassan had any knowledge that the uncertified statements which were prepared would be issued to prospective purchasers of partnership interests.

Plaintiffs then repeat in shopping list fashion all of the various "facts" set forth in Count 1 of the complaint (§§ 20-

37(k)) which "should have been included in those brochures [and which] the Hassan firm willfully or recklessly failed to do." (§ 49)

Conspicuous by its absence is any allegation that Hassan knew of and intentionally sought to hide any of the alleged wrongs.

The Complaint further alleges that the financial statements which were included in the brochures failed to disclose any of the "facts" (§ 50); that the financial statement contained inaccurate and artificially created figures obtained from Garfinkle which were not verified by Hassan and which did not represent actual or historic information and which were deceptive and misleading (§ 51-52); that the financial statements concerning projections of income, cash flow and profit, etc. were prepared by Hassan and distributed to prospective investors (§ 53); that neither Stonehenge nor the partnerships kept books in accordance with good bookkeeping practice or accepted accounting principles and that Hassan knew this but failed to disclose it (§ 54); that Hassan knew but failed to disclose commingling of funds (§ 55); that Hassan reviewed and participated in the preparation of sales brochures distributed to prospective investors and made no attempt to disclose the foregoing information (§ 56); that Hassan knew there would be no S.E.C. registration, although it was required and Hassan deliberately omitted this information from the circular (§ 57).

Plaintiffs further claim the alleged omitted or misleading statements in the brochure were material and relied on by them in making their purchase (§§ 58-59) but, plaintiffs do not allege what it was that made the alleged omissions and misstatements material, nor do they state how they relied

on the financial statements, nor do they allege that Hassan knew "about the fraud to be committed and knowingly rendered positive aid to it." *Frazier v. Stellar Industries, Inc.*, *supra* 72 Civ. 2829 (D.C. Cal. Nov. 15, 1973 p. 24 of slip opinion); *Keene Corp. v. Weber*, 394 F. Supp. (787, 790) (SDNY 1975).

Plaintiffs also allege that Hassan violated certain AICPA rules and standards (§ 60); specifically it is alleged that the purported statements should have contained an expression of opinion but did not (§ 61); that Hassan obtained its information from Garfinkle and that this information should have been disclosed since AICPA rules require an auditor to disclose that he is making reference to the report of another auditor (§ 62); that the use of the words "unaudited" or "pro forma" did not justify misleading omissions (§ 63); that Hassan should have revised the statements when it became aware of its deficiencies (§ 64); that Hassan should have advised the S.E.C. of the statements' alleged deficiencies (§ 65); and that Hassan aided and abetted the alleged fraud (§ 66 and 67).

We respectfully submit that this Court need look no further than the discussion in *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973), and the opinion of the Ninth Circuit in *Wessel v. Buhler*, 437 F.2d 279 (9th Cir. 1971), to dispose of appellants' claim against Hassan.

In one way or another all of the foregoing seek to connect Hassan to financial statements which are purportedly false. However, as Judge Metzner noted in his opinion:

"Those financial statements, attached to the Complaint as Exhibits A, B, C, were neither certified by [Hassan] nor identified with Hassan in any way" and "a reading of [the statements] shows that the alleged omis-

sions were not required to be included in order to make them complete for their intended purpose." (102a-103a)

Thus, in this case, as in *Gold v. DCL Inc.*, 399 F. Supp. 1123 (SDNY 1973), we respectfully submit that even if the complaint did contain an allegation by which it might be inferred that Hassan had knowledge of the facts as plaintiffs allege, there is nothing before this Court which possibly lead to a finding that there exists between Hassan and plaintiffs "the kind of special relationship which has heretofore imposed on auditors a duty of disclosure." 399 F. Supp. at 1127.

It is abundantly clear from the foregoing that appellants' goal was to sue anyone remotely connected with Stonehenge. It is even clearer that appellants have failed to satisfy the pleading requirements of Fed. R. Civ. P. 9(b).

Plaintiff's reliance on *U.S. v. Natalie*, 527 F. 2nd 311 is misplaced in view of the fact that Natalie involved criminal charges against an accountant who knowingly issued false and misleading financial statements. In any event it is indeed ironic that Plaintiff relies on a Second Circuit case for the proposition of the Second Circuit misapplies the requirements of Rule 9(b).

None of the cases relied on by petitioner has any bearing upon the issue before this Court, that is, whether or not certiorari should be granted. Indeed, they serve only to emphasize that this case has no importance beyond the particular facts and parties involved. It is impossible to discern in the petition before this Court any question of significance in terms of interpretation of any federal statute or the administration of the federal courts. The

petition fails completely to set forth any considerations of the character enumerated in Rule 19 of this Court which traditionally have influenced the Court to grant certiorari.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Dated: New York, New York
June 16, 1978

Respectfully submitted,

KENNETH A. SAGAT
ROBERT P. O'NEILL
PAUL A. IMMERMANN

70 Pine Street

New York, New York 10005

Attorneys for Respondents

Ritch, Greenberg & Hassan

Of Counsel:

D'AMATO & LYNCH

70 Pine Street

New York, New York 10005